91-1177

Supreme Court, U.S.
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NO. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

LYNNE C. CZARNESKI,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE
Respondent

Petition For Writ Of Certiorari To The United States Court of Appeals For The Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

A divorced wife discovered for the first time on appeal that the United States Tax Court, in direct violation of I.R.C. §§ 7452 and 7453 and of Rule 201(a) of the Tax Court Rules of Practice and Procedure, permitted one of the trial counsel for the petitioners before the Tax Court to testify at trial as a material witness on the central issue of the case. The divorced wife also discovered for the first time on appeal that the Tax Court had asked the trial counsel to obtain from all Tax Court petitioners written waivers of the trial counsel's conflicts of interest in acting as trial counsel in addition to their other roles in the case. The divorced wife also discovered for the first time on appeal that the trial counsel misled the Tax Court by stating that they had obtained written waivers from all petitioners when, in fact, they had not obtained nor requested a waiver from the divorced wife, petitioner herein. The divorced wife never had an opportunity, therefore, to raise her innocent spouse defense under IRC § 6013(e).

1. Can a federal appeals court, in direct conflict with the Supreme Court's holding in *Hormel v. Helvering, C.I.R.*, 312 U.S. 552 (1941), refuse to consider for the first time on appeal the divorced wife's claim for a new trial?

2. Should the Supreme Court in this situation exercise its supervisory powers to preserve the integrity of the Tax Court and, thereby, prevent the denial of due process to the divorced wife?

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1. The caption of this case contains the names of all parties to this proceeding.

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NO. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

LYNNE C. CZARNESKI,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE
Respondent

Petition For Writ Of Certiorari
To The United States Court of Appeals
For The Ninth Circuit

The petitioner Lynne C. Czarneski respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit, entered in the above-entitled proceeding on July 26, 1991.

OPINIONS BELOW

The July 26, 1991, opinion of the Court of Appeals for the Ninth Circuit is not reported. It is reprinted in the appendix at A-1.

The August 30, 1988, opinion of the United States Tax Court is reported as *Ewing v. CIR*, 91 T.C. 396 (1988). It is reprinted in the appendix at A-9.

The December 13, 1991, order of the United States Tax Court is not reported. It is reprinted in the appendix at A-46.

JURISDICTION

The opinion sought to be reviewed is the Ninth Circuit's judgment entered July 26, 1991.

On September 19, 1991, the Ninth Circuit entered an order denying Lynne C. Cznarneski's petition for rehearing and for rehearing en banc.

On December 4, 1991, Justice Sandra Day O'Connor ordered that the time for filing this petition be extended to and including January 17, 1992.

The jurisdiction of this Court to review the judgment of the Ninth Circuit is invoked under 28 U.S.C. § 1254 (1).

CONSTITUTIONAL, STATUTORY, AND OTHER PROVISIONS INVOLVED

U.S. Constitution, Amendment V (Appendix A-48)
Internal Revenue Code Sections:

26 U.S.C. § 7452 (Appendix A-49)
26 U.S.C. § 7453 (Appendix A-49)
26 U.S.C. § 7482(c)(1) (Appendix A-49)

Rule 201(a), Rules of Practice and Procedure, United States Tax Court (Appendix A-50)

Rule 3.7, Rules of Professional Conduct of American Bar Association (Appendix A-50)

STATEMENT OF THE CASE

Certain attorneys from the Beverly Hills law firm of Hochman, Salkin, & DeRoy concocted a gold straddle tax shelter investment. The attorneys wrote the tax opinion underlying the investment, conducted the straddle transactions, promoted the tax shelter, and even invested in

the tax shelter themselves. *See* the Tax Court's opinion in *Ewing v. C.I.R.*, 91 T.C. 396, 406-408, 411-13, 418-20, reprinted in the appendix at A-9, A-21-25, A-28-32, A-37-41.[2] When the Internal Revenue Service disallowed the claimed tax treatment from the straddle, the law firm filed petitions to the United States Tax Court on behalf of several husband and wife taxpayers whose cases were consolidated for trial. Ninth Circuit Opinion, A-1. During trial, the Tax Court permitted one of the attorneys from the law firm, Mr. Avram Salkin, to testify as a material witness on the central isue of the case: whether the taxpayers entered into the gold straddle investment primarily for profit as required by I.R.C. § 165(c)(2). The Tax Court found that the taxpayers did not have the requisite profit motive and based its opinion on several factors: (1) the language in Salkin's 23-page tax opinion in the promotional materials of the investment; (2) the mechanics of the trading transactions engineered and conducted by Salkin and his law firm; and (3) Salkin's testimony at trial, which indicated the taxpayer's lack of proper intent. 91 T.C. at 418-20, A-37-41.

The Tax Court recognized that there was a serious conflict of interest in Mr. Salkin's and the law firm of Hochman, Salkin, & DeRoy's acting as trial counsel for Tax Court petitioners in view of the multiple conflicts of interest raised by the law firm's and Mr. Salkin's involvement in the gold straddle tax shelter. The Tax Court's published opinion reveals that the Tax Court raised the issue of the conflict on its own at 91 T.C. 397, n. 2, A-10 as follows:

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2. The Tax Court, by order dated June 26, 1989, revised its published opinion of August 30, 1988, at 91 T.C. at 420, A-40, to refer to the attorneys' actions as those of "promoters" rather than "organizers."

> Respondent [the Commissioner] stipulated that he has no objection to the law firm of Hochman, Salkin, & DeRoy and its individual members, including specifically Bruce I. Hochman and Avram Salkin, serving as counsel for petitioners in these proceedings. At the suggestion of the Court, petitioners' counsel also sought and received specific waivers from the individual petitioners with respect to any potential conflict of interest.

But, contrary to the Tax Court's footnote, the attorneys in question did not obtain nor request any such waiver from Lynne C. Czarneski. *See* Lynne C. Czarneski's affidavit of December 6, 1990, attached to her Motion to Remand filed December 7, 1990, in the Ninth Circuit and opening brief filed by Hochman, Salkin, & DeRoy in the Ninth Circuit on behalf of other appellants.

Lynne C. Czarneski was divorced from Don A. Czarneski on May 2, 1983, nearly one year before the Internal Revenue Service forwarded the Czarneskis the statutory notice of deficiency underlying the Tax Court proceedings in issue. The statutory notice was mailed only to the address of Don A. Czarneski. *See* Czarneski affidavit. The attorneys from Hochman, Salkin, & DeRoy on May 18, 1984, filed a joint Tax Court petition on behalf of both Don A. Czarneski and Lynne C. Czarneski in the Tax Court, at no time noting in the petition nor in any subsequent pleading that the Czarneskis were divorced for over one year prior to the filing of the petition. *See* Czarneski affidavit.

Lynne C. Czarneski did not know that the attorneys from Hochman, Salkin, & DeRoy wrote the tax opinion for the gold straddle investment, promoted the investment, invested personally in the investment, and conducted the straddle transactions. She did not know that the Tax

Court on its own initiative requested that the attorneys for petitioners obtain specific waivers from all Tax Court petitioners concerning the attorneys' conflicts of interest. The attorneys from Hochman, Salkin, & DeRoy never communicated with her about anything. She never knew the Tax Court trial took place in November 1985. She never knew the Tax Court's opinion was published in 1988 and that the Tax Court entered a decision against her on March 12, 1990. She never knew an appeal was taken. In the late summer of 1990, Lynne C. Czarneski telephoned her former husband on an unrelated matter. He informed her for the first time that the gold straddle case was on appeal to the Ninth Circuit. He told her that if the appeal was lost he was going to file for bankruptcy and sue the lawyers in California. He told her not to worry because he would not tell "them" where she was. Lynne C. Czarneski then contacted one of the undersigned counsel, Diana Dowd Ulrich, who informed her for the first time of the Tax Court's opinion and decision against her. Czarneski affidavit.

Lynne C. Czarneski's undersigned counsel made entries of appearance on her behalf in the Ninth Circuit on September 20, 1990. On December 7, 1990, undersigned counsel filed in the Ninth Circuit a Motion to Remand Case for Conflict of Interest and Other Reasons to United States Tax Court or, Alternatively, to Supplement Record on Appeal. The Ninth Circuit denied the Motion on January 8, 1991, without giving reasons for the denial. The Ninth Circuit eventually rendered its opinion of July 26, 1991, declining to consider for the first time on appeal Ms. Czarneski's claim for a new trial. Ms. Czarneski thereafter moved the Tax Court, as suggested in the Ninth Circuit's opinion, to indicate how it would rule

on a Motion to Vacate Decision or a Motion to Reconsider its Opinion. The Tax Court on December 13, 1991, issued its order that Ms. Czarneski would be entitled to an evidentiary hearing on her Motions if the Ninth Circuit sees fit to remand the case to the Tax Court. Presently pending before the Ninth Circuit is Ms. Czarneski's Motion to Remand filed January 9, 1992.

REASONS FOR GRANTING THE WRIT

I. The Ninth Circuit's Judgment Conflicts with the Supreme Court's Interpretation of I.R.C. § 7482(c)(1).

The Internal Revenue Code empowers the Courts of Appeals "to modify or reverse the decision of the Tax Court, with or without remanding the case for a rehearing, as justice may require." The Supreme Court cited this grant of authority to the Courts of Appeals in holding that a Court of Appeals should not make an "inflexible practice" of passing by questions not raised in the Board of Tax Appeals (the precursor of the present-day Tax Court). *Hormel v. Helvering, C.I.R.*, 312 U.S. 552, 556-57 (1941). The Supreme Court specifically held that the practice of appellate courts of "confin[ing] themselves to the issues raised below" should not be applied "where the obvious result would be a plain miscarriage of justice." *Id.* at 558. In a new trial, Ms. Czarneski can raise an innocent spouse defense under IRC § 6013(e).

The Ninth Circuit's judgment plainly causes a miscarriage of justice in the instant case. The Ninth Circuit on January 8, 1991, issued an order without reasons denying Ms. Czarneski's request for a remand to the Tax Court after she hired separate counsel and learned for the first time on appeal that trial counsel operated under serious conflicts of interest and were permitted to testify

at trial in violation of the Internal Revenue Code and of the Tax Court's own Rules, all as described more fully below. The Ninth Circuit's judgment then inflexibly confines itself to the issues presented in the Tax Court, in direct conflict with the provisions of I.R.C. § 7482(c)(1) and with this Court's interpretation of it. Even prior Ninth Circuit precedent in Tax Court appeals permits hearing of an issue for the first time on appeal where "review is necessary to prevent a miscarriage of justice or to preserve the integrity of the judicial process" (citations omitted) or "when the issue presented is purely one of law and either does not depend upon the factual record developed below, or the pertinent record has been fully developed" (citations omitted). *Bolker v. C.I.R.*, 760 F.2d 1039, 1042 (9th Cir. 1985). The Ninth Circuit's judgment, in such direct conflict with the Internal Revenue Code, this Court's prior precedent, and even prior Ninth Circuit precedent presents such an egregious and fundamental violation of due process that certiorari is warranted in this case.

II. The Supreme Court should Exercise its Supervisory Powers to Preserve the Integrity of the Judicial Process both of the Ninth Circuit and of the Tax Court.

The Internal Revenue Code requires that ". . . the proceedings of the Tax Court and its divisions shall be conducted in accordance with such rules of practice and procedure . . . as the Tax Court may prescribe . . ." Section 7453, A-49. The Code further requires that ". . . The taxpayer shall continue to be represented in accordance with the rules of practice prescribed by the Court . . ." Section 7452, A-49. One of the Tax Court's Rules of Practice & Procedure, Rule 201(a), requires

that "Practitioners before the Court shall carry on their practice in accordance with the letter and spirit of the Rules of Professional Conduct of the American Bar Association," A-50 .Rule 3.7 of the ABA Rules strictly prohibits trial counsel from testifying before the Tax Court except in very limited situations not applicable here, such as testifying regarding attorney's fees or an uncontested issue.

The fact that Mr. Salkin, one of the trial counsel for the Tax Court petitioners, was permitted to testify at trial is indisputable. Ninth Circuit's opinion, A-5; Tax Court's opinion (91 T.C. at 420) A-40-41. The fact that Mr. Salkin and his law firm acted as trial counsel is also indisputable. Ninth Circuit's opinion, A-3. The Tax Court, in the face of the law firm's multiple conflicts of interest in the gold straddle, permitted the trial to proceed in violation of Tax Court Rule 201(a) and of I.R.C. §§ 7452 and 7453. *See* Ninth Circuit's opinion, A-3 (recognizes law firm's "involvement" in gold straddle); Tax Court opinion (91 T.C. at 406-13, 420) A-9, A-21-32 (outlines details of law firm's involvement in the gold straddle and makes the following holding: "This testimony by Salkin [trial counsel for petitioners], one of the principal organizers of Hunter, a general partner in C.D., and the individual primarily responsible for placing all petitioners in the program is particularly telling as to their intent. Furthermore, under the circumstances, we find it impossible to believe that Salkin did not discuss these loss targets with each petitioner." 91 T.C. at 420, A-41). The Tax Court's decision to permit Mr. Salkin to testify on the crucial issue of the taxpayers' intent flies into the face of the Tax Court's own decision of *Duffey v. C.I.R.*, 91 T.C. 81 (1988), in which the Tax Court disqualified the tax-

payers' counsel because counsel was to testify on the crucial issue of taxpayers' intent or motive. Further, the Tax Court has since adopted new Tax Court Rule 24(f), effective July 1, 1990, emphasizing again that trial counsel is not to testify when he is a potential witness in a case. 93 T.C. 857, 858.

Similarly, the Ninth Circuit in another case has recently recognized the due process violations of Tax Court trials held in violation of the Tax Court Rules. In *Guenther v. C.I.R.*, 889 F.2d 882, 884 (9th Cir. 1989), the Ninth Circuit temporarily remanded its case to the Tax Court for a hearing on the taxpayers' contentions that they were denied a fair trial and due process of law by the Tax Court's failure to conduct the trial in accordance with I.R.C. §§ 7452 and 7453 and Tax Court Rule 21(a) (ex parte contact by a party with Tax Court). After remand the Ninth Circuit found the Tax Court's conduct to be an "institutionalized due process violation." *Guenther v. C.I.R.*, 939 F.2d 758, 762 (9th Cir. 1991).

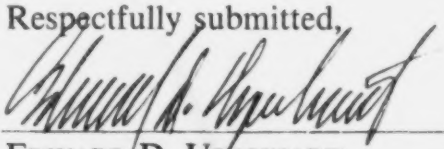
The Tax Court violated the Internal Revenue Code and its own Tax Court Rules in the way it conducted Lynne C. Czarneski's trial. The Ninth Circuit on appeal refused to remand Ms. Czarneski's case for a hearing as it should have under *Guenther*. The Ninth Circuit then, in its ultimate opinion in this case, let stand a Tax Court decision similar to that which the Ninth Circuit in *Guenther* termed an "institutionalized due process violation." The Supreme Court must exercise its supervisory powers to grant this petition for certiorari to protect Ms. Czarneski's due process rights and to preserve the integrity of the judicial process both of the Tax Court and of the Ninth Circuit. The fact that both courts have so far departed from their own recognitions of the re-

quirements of justice requires certiorari to be granted in this case.

CONCLUSION

This Court should grant certiorari to preserve the integrity of the judicial proces both of the Ninth Circuit and of the Tax Court, to correct the Ninth Circuit's judgment rendered in violation of Supreme Court precedent, and to protect Lynne C. Czarneski's right to due process of law and to raise her innocent spouse defense under IRC § 6013(e).

Respectfully submitted,



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January 17, 1992

APPENDIX

Not For Publication

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Filed July 26, 1991

No. 90-70291

Tax Ct. No. 13442-84

MEMORANDUM*

ARTHUR TOLL; CHARLOTTE TOLL,
Petitioners

v.

COMMISSIONER INTERNAL REVENUE SERVICE,
Respondent.

No. 90-70293

Tax Ct. No. 13443-84

RICHARD B. LEAVITT; ROBERTA LEAVITT
Petitioners

v.

COMMISSIONER INTERNAL REVENUE SERVICE,
Respondent.

No. 90-70294

Tax Ct. No. 3896-84

PHILLIP M. EWING; MARIAN S. EWING,
Petitioners

v.

COMMISSIONER INTERNAL REVENUE SERVICE,
Respondent.

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* This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as provided by 9th Cir. R. 36-3.

No. 90-70444
Tax Ct. No. 14511-84
DON A. CZARNESKI; LYNNE C. CZARNESKI;
RICHARD W. LEONG; JUNE D. LEONG,
Petitioner,
v.
COMMISSIONER INTERNAL REVENUE SERVICE,
Respondent.

Appeal from the United States Tax Court
Argued and Submitted Thursday, July 11, 1991
Pasadena, Californa
Before: REINHARDT and FERNANDEZ, Circuit Judges, and CROCKER, District Judge.**

All petitioners appeal the tax court's ruling that they are liable for deficiencies in tax payments for 1980 and 1981. As to all but Arthur and Charlotte Toll ("the Tolls") and Richard and Roberta Leavitt ("the Leavitts"), we affirm the tax court's finding that they did not enter into certain commodities transactions primarily for profit, and are therefore liable for the deficiencies. The Tolls and Leavitts argue that the tax court had no jurisdiction over their petitions. We agree and order the matter dismissed as to them. Petitioner Lynne Czarneski also argues that she is entitled to a new trial based on her attorney's conflict of interest. We decline to address this issue, which was not raised before the tax court.

BACKGROUND

Petitioners participated in an investment program offered by F. G. Hunter and Associates ("Hunter"). Through Hunter, petitioners purchased gold futures

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** The Honorable M.D. Crocker, District Judge for the Eastern District of California, sitting by designation.

straddle contracts.[1] Hunter offered innovative methods for closing out the legs of petitioners' straddle contracts.

Instead of offsetting a losing leg, Hunter would sell it outright so as to produce an ordinary loss rather than a capital loss. Ordinary losses allow greater income tax deductions than capital losses. Instead of closing out or offsetting a profitable "short" position on the contract, Hunter would assign or sell the position so as to produce a long-term capital gain rather than a short-term capital gain. Long-term capital gains are taxed at a more favorable rate than short-term capital gains.

Petitioners all followed Hunter's methods and claimed ordinary losses on their income tax returns. The Commissioner disallowed the ordinary losses and sent notices of deficiency to petitioners. Each petitioner filed for a redetermination, and a trial was held in November 1985.

The law firm of Hochman, Salkin and DeRoy represented petitioners at trial. Hochman and Salkin were involved in obtaining petitioners' participation in Hunter's program, and were the general partners in the limited parnership through which the Tolls and the Leavitts invested.

The tax court found that the transactions were not primarily for profit, and therefore could not be deductetd as ordinary losses under section 108(a) of the Tax Reform Act of 1984. The tax court did, however, allow petitioners to offset their losses against their gains. All petitioners appeal those rulings.

Petitioners, the Tolls and the Leavitts, argue on appeal

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1. A detailed explanation of a futures straddle contract is found in *Miller v. Commissioner*, 836 F.2d 1274, 1276-77 (10th Cir. 1988).

that there is no jurisdiction over them because the Commissioner failed to make an actual determination that they had a tax deficiency. Ms. Czarneski filed a separate appellate brief arguing that she should be granted a new trial because she did not waive trial counsel's conflicts of interest.

JURISDICTION AND STANDARDS OF REVIEW

We have jurisdiction pursuant to 26 U.S.C. § 7482.

We review the tax court's conclusion that petitioners did not enter the transactions primarily for profit for clear error. *Independent Elec. Supply, Inc. v. Commissioner*, 781 F.2d 724, 727 (9th Cir. 1986). We interpret the meaning of a statute de novo. *Batchelor v. Oak Hill Medical Group*, 870 F.2d 1446, 1447 (9th Cir. 1989).

DISCUSSION

A. Ordinary Loss Deductions

Section 108 of the Tax Reform Act of 1984, Pub. L. No. 98-369, 98 Stat. 494, as amended by the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085, provides in pertinent part:[2]

> [I]n the case of any disposition of 1 or more positions which were entered into before 1982 and form part of a straddle, . . . any loss from such disposition shall be allowed for the taxable year of the disposition if such loss is incurred . . . in a transaction entered into for profit. . . .

We have interpreted this section to mean that petitioners in this case could deduct their "losses" from transactions involving gold futures only if their *primary*

2. Section 108 is no longer in effect, but its text is cited in the historical notes following 26 U.S.C. § 1092.

motive was economic profit. *Landreth v. Commssioner,* 859 F.2d 643, 649 (9th Cir. 1988). The tax court found that petitioners entered the transactions primarily for the purposes of generating losses for tax purposes rather than making a profit.

The tax court's conclusion is supported by evidence that: the principal thrust of Hunter's promotional materials was the favorable tax advantage through unusual closing procedures, the trading practices of petitioners was inconsistent with a primary profit motive, petitioners traded in thin markets which would not allow them to realize profits, petitioners paid higher commissions in order to benefit from Hunter's special closing procedures although there was no corresponding benefit other than tax write-offs, Salkin himself testified he had a specific tax loss in mind. The tax court's conclusion was not clearly erroneous.

B. Jurisdiction Over the Tolls and Leavitts

The notice of deficiency sent to the Tolls and the notice of deficiency sent to the Leavitts each informed them that a proposed deficiency was being assessed at a 70% rate "since your original income tax return is unavailable at this time." In *Scar v. Commissioner,* 814 F.2d 1363 (9th Cir. 1987), the notice contained language identical to that on the notice sent to the Tolls and the Leavitts. We held that whether the tax court has jurisdiction over a petition for redetermination of a notice of deficiency is determined under 26 U.S.C. § 6212(a). That section requires the Commissioner to make an actual determination that there is a deficiency before issuing a notice. *Scar,* 814 F.2d at 1366. "[T]he Commissioner must consider information that relates to a particular taxpayer

before it can be said that the Commissioner has 'determined' a 'deficiency' in respect to that taxpayer." *Id.* at 1368.

In *Scar,* we found no jurisdiction over taxpayer's petition because the notice of deficiency stated on its face that the Commissioner had not reviewed the taxpayer's actual return, and the notice referred to a tax shelter that had no connection to the petitioner. In the present case, the Commissioner's notice to the Tolls and Leavitts plainly states that their returns were unavailable for review, although it does refer to the correct tax shelter. A mere failure to review the returns is enough to result in a jurisdictionally fatal defect. *Id.* at 1367 n.6; *Kong v. Commissioner,* 60 T.C.M. 696 (1990) (where return not reviewed, *that* alone is sufficient to require dismissal). Therefore, the same result must obtain here.

The Commissioner suggests that we remand to the tax court so that he can have an opportunity to prove that a proper determination was made. That request is made at this time because, unlike other reported cases, the Tolls and the Leavitts first raised the jurisdiction issue on appeal, and that deprived the Commissioner of an opportunity to demonstrate compliance. In *Clapp v. Commissioner,* 875 F.2d 1396 (9th Cir. 1989), we indicated, in dicta, that "where the notice of deficiency reveals on its face that the Commissioner failed to make a determination . . . the Commissioner [is] required to prove that he did in fact make a determination." *Id.* at 1402. *See also Campbell v. Commissioner,* 90 T.C. 110, 112-113 (1988) to the same effect.

While at first blush *Clapp* might seem to be in conflict with the rigid rule set forth in *Scar,* it is not. *Clapp* does

not suggest that the Commissioner can establish jurisdiction by a showing short of one that demonstrates that he in fact did conduct an examination of the taxpayer's returns. If that were what the Commissioner sought to present evidence about, we would certainly look favorably upon the request to return the case to the tax court.[3] However, the Commissioner makes no such representation to us. Rather, what has been suggested to us by the Commissioner indicates that the returns were *not* reviewed.[4] Thus, the tax court lacked jurisdiction over the petitions of the Tolls and the Leavitts.

C. Ms. Czarneski's New Trial Claim

Ms. Czarneski argues for the first time on appeal that she never waived trial counsel's alleged conflicts of interest, including his own testimony at trial. Indeed, she suggests that she did not even know about them at the time of trial and, thus, could not waive them. She indicates that the trial judge was not informed of the problems and was even misled when he expressed concern about them.

Ms. Czarneski's proper remedy would have been to file a motion in the tax court under Tax Court Rules of Practice & Procedure 161 or 162, 26 U.S.C.A. foll. § 7453 (West 1986 & supp. 1991). Although we express no opinion on whether the tax court can or should grant the motion, we decline to address the new trial issue until the tax court has ruled on the merits of Ms. Czarneski's[5]

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3. We do not mean to say that proof that all pertinent information from the return had been reviewed in electronic or other form could not be a substitute for looking at the paper return itself.

4. In fact, the 70% factor used in the notices strongly militates against review, and nothing in the briefs or at oral argument indicated otherwise.

5. If Ms. Czarneski did not discover the grounds for her new trial claim until after the appeal in this case was filed, that still does not allow her to raise the issue for the first time on appeal.

assertion.[5] *See Slavin v. Commissioner*, 932 F.2d 598, 599-600 (7th Cir. 1991). *See also Billingsley v. Commissioner*, 868 F.2d 1081, 1084 (9th Cir. 1989).

C. Deducting Net Losses

Petitioners argue for the first time on appeal that they should be able to deduct their net losses under section 108(c) of the Tax Reform Act of 1984, as amended in 1986. Since the issue was not raised before the tax court, we decline to hear it now. *See Anderson v. Cumming*, 827 F.2d 1303, 1305 (9th Cir. 1987).

CONCLUSION

We AFFIRM the tax court's ruling that petitioners the Ewings, the Czarneskis and the Leongs are not allowed to deduct losses incurred in Hunter's gold straddles program under section 108(a), and that they are not entitled to deduct their net losses under section 108(c). We grant the petition of the Tolls and the Leavitts since the tax court had no jurisdiction over them. We decline to rule on Ms. Czarneski's request for a new trial, because it is not properly before us. However, our affirmance of the judgment against her is not intended to preclude her rights, if any, to raise her claims of conflict before the tax court. Nor do we intend to indicate if or how the tax court should rule if the claims are hereafter raised before it.

Although filing a notice of appeal divests a trial court of jurisdiction to dispose of a motion for reconsideration or vacation, the proper remedy in that case is to ask the tax court to indicate whether it wishes to entertain the motion and, if the court indicates it will, ask the appellate court to remand to the trial court so that the proper order may be entered. *Smith v. Lujan*, 588 F.2d 1304, 1307 (9th Cir. 1979) (deciding the issue in the context of Fed. R. Civ. P. 60(b), which governs how a party should seek relief from a final judgment of a federal trial court).

Petitions GRANTED as to the Tolls and the Leavits and otherwise DENIED.

PHILLIP M. EWING AND MARIAN S. EWING, ET AL.,[1] Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 3896-84, 13442-84, 13443-84, 14511-84, 27900-84

Filed August 30, 1988

During 1980 and 1981, petitioners were engaged as investors and not as dealers in straddle transactions in gold futures. They deducted ordinary losses on their 1980 returns from the "cancellation" of the losing legs of straddles and reported long-term capital gains on their 1981 returns from the "assignment" of winning legs. *Held:*

1. For the purpose of determining whether the straddle transactions were "entered into for profit" within meaning of sec. 108(a) of the Tax Reform Act of 1984, Pub. L. 98-369, as amended by sec. 1808 of the Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2817, the proper test is the "primarily for profit" standard applicable to losses under sec. 165(c)(2), I.R.C. 1954.

2. Losses disallowed in 1980 by sec. 108(a) as amended are allowable as offset in 1981 against gains from disposition of the straddle positions. Sec. 108(c); Sec. 1.165-13T, Q&A-3, Temporary Income Tax Regs.

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1. Cases of the following petitioners were consolidated for trial, briefing, and opinion: Arthur Toll and Charlotte Toll, docket No. 13442-84; Richard B. Leavitt and Roberta Leavitt, docket No. 13442-84; Don A. Czarneski and Lynne C. Czarneski, docket No. 14511-84; and Richard W. Leong and June D. Leong, docket No. 27900-84.

3. Petitioners are liable for increased interest under sec. 6621(c), formerly sec. 6621(d), for underpayment attributable to tax-motivated transactions.

4. Under the circumstances of these cases, additions for negligence under sec. 6653(a)(1) are not applicable, and the award of damages under sec. 6673 is declined.

Bruce I. Hochman, Avram Salkin, James V. Looby,[2] and *Charles P. Rettig,* for the petitioners.

Pamela R. Piland, for the respondent.

SHIELDS, *Judge*: In his notices of deficiency, respondent determined deficiencies in and additions to petitioners' Federal income taxes as follows:

			Additions to tax	
Docket No./ petitioners	*Year*	*Deficiency*	*Section 6653(a)(1)*[3]	*Section 6653(a)(2)*
3896-84	1980	$63,008.00	$3,150.00	—
Ewing(s)	1981	56,444.00	2,822.00	—
27900-84	1980	12,747.00	637.35	—
Leong(s)	1981	66,212.01	3,310.60	50% of Interest due on $3,310.60
14511-84	1980	70,025.92	3,501.30	—
Czarneski(s)	1981	132,049.49	6,602.47	50% of Interest due on $6,602.47
13442-84 Toll(s)	1980	85,283.00	—	—
13442-84 Leavitt(s)	1980	146,041.70	—	—

2. Respondent stipulated that he has no objection to the law firm of Hochman, Salkin & DeRoy and its individual members, including specifically Bruce I. Hochman and Avram Salkin, serving as counsel for petitioners in these proceedings. At the suggestion of the Court, petitioners' counsel also sought and received specific waivers from the individual petitioners with respect to any potential conflict of interest.

3. All section references are to the Internal Revenue Code of 1954 as in effect during the years in issue, unless otherwise indicated.

By amended answers, respondent determined that all petitioners are liable for increased interest under section 6621(c),[4] petitioners in docket No. 3896-84 (Ewings) are liable for an addition to tax under section 6653(a)(2) in 1981 equal to 50 percent of the interest due on $2,822, and petitioners in docket Nos. 13442-84 (Tolls) and 13443-84 (Leavitts) are liable for additions to tax under section 6653(a)(1) in 1980 of $4,264.15 and $7,302.08, respectively. At trial, respondent orally moved that damages be awarded to the United States and against all petitioners under section 6673.

After concessions, the issues remaining for decision are: (1) Whether certain transactions in gold futures were entered into by Mr. Ewing, Mr. Leong, Mr. Czarneski, Mr. Toll, and Mr. Leavitt for profit, and if so, whether their losses from such transactions are ordinary losses or short-term capital losses, and whether their gains from such transactions are long-term or short-term capital gains; (2) whether the fees paid by the male petitioners with respect to such transactions are deductible; (3) whether petitioners are liable for additions to tax under section 6621(c), section 6653(a)(1), and section 6653(a)(2) as determined by respondent; and (4) whether damages should be awarded under section 6673.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulations and exhibits associated therewith are incorporated herein by reference.

All Rule references are to the Tax Coure Rules of Practice and Procedure, unless otherwise provided.

4. Respondent cites to sec. 6621(d), which was redesignated sec. 6621(c) by sec. 1511(c)(1)(A) of the Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2085, 2744. All such references made herein are to the redesignated section.

The Ewings, Tolls, and Leavitts resided in California at the time their petitions were filed, and their joint income tax returns for the years in issue were filed with the Internal Revenue Service Center at Fresno. The Czarneskis and Leongs resided in Texas at the time their petitions were filed, and their joint income tax returns for the years in issue were filed with the Internal Revenue Service Center at Austin. The returns of all petitioners were prepared utilizing the cash receipts and disbursements method of accounting.

As used hereinafter, the words "petitioner" and "petitioners" will refer only to the male petitioners unless otherwise indicated, and the use in our findings of such words and phrases as "loss," "gain," "forward contract," "cancellation," "assignment," "spread," "straddle," "short position," "long position," "transactions," and similar words and phrases are for convenience only, and are not to be construed as a determination of the nature of any act or thing.

Each male petitioner herein is a successful professional or businessman who had a substantial sum of ordinary income from his profession or business during each of the years in issue. On their income tax returns, each petitioner claimed deductions from his professional or business income for losses from the "cancellation" of gold futures contracts in the amounts and for the years shown below:

Petitioner	*Year*	*Losses*
Ewing	1980	$107,563
	1981	116,096
Toll	1980	103,835
Leavitt	1980	103,835
Czarneski	1980	227,400

	1981	359,600
Leong	1980	35,000
	1981	198,200

All of the above losses purportedly occurred with respect to transactions in gold futures conducted during 1980 or 1981 in the manner hereinafter described on behalf of petitioners by F. G. Hunter & Associates. Petitioners did not engage in the transaction as dealers.

Trading in Commodity Futures in General

Trading in futures contracts occurs with respect to commodities including precious metals. In general, a futures contract is an agreement to either deliver (a short position) or receive (a long position) a specified quantity and grade of a designated commodity during a designated month in the future. A single position calling for the purchase or the sale of a designated commodity is described as an "open contract." However, if the same person acquires a position calling for the purchase of a specified commodity and a different position calling for the sale of the same commodity, his position is described as a straddle and each of such position is referred to as a "leg" of the straddle.

Persons trading in commodity futures seldom hold contracts to the closing date so as to make or receive delivery of the specified commodity. In fact, it is generally understood that less than 5 percent of all futures contracts actually result in the delivery of the underlying commodity. Instead, such contracts are generally disposed of by a "switch transaction," which is the acquisition of an offsetting contract of purchase or sale of the same quantity of the commodity.

Whenever an open position is held, price changes in the commodity future directly affect the economic position of

the holder. By contrast, in a straddle, the holder is economically affected only by changes in the spread, i.e., the difference between the market price of each leg of the straddle. If the prices of the short and long legs of the straddle move exactly in tandem so that the spread does not change, the holder will suffer no economic consequence since his unrealized loss in one leg will be offset by his unrealized gain in the other. However, if the spread widens or narrows, the holder will incur either an economic gain or loss.

The potential for gain or loss in a straddle transaction is a function of the change in the price relationship or differential between the delivery months. The price differential, in turn, is a function primarily of the changes in short-term interest rates and the value of the underlying commodity and secondarily of storage and commission costs. Because storage costs are trivial for precious metals, the major forces affecting a gold futures spread are movements in gold prices and short-term interest rates.

Whenever a leg of a straddle is closed out by the purchase of an exactly opposite position, or in any other manner, tax consequences normally will result to the holder in either a realized gain or loss. In such a case, where the straddle consists of only two positions, that position which is not closed out becomes simply an open contract. As a general rule in tax-motivated straddle trading, the loss leg will be closed out first in order to generate a tax loss for the holder. When this occurs, the remaining leg of the initial straddle containing an unrealized gain, which is usually almost identical to the amount of loss in the closed leg, constitutes an open position for the holder, and as such, is subject to the increased risk of being directly affected by the market. To

minimize this risk, the holder would be expected to obtain a new position similar to the one in the closed loss leg except for a different month. This substitution of one position for a similar position in a different month (switching) of the loss leg in the initial year in order to generate a tax loss which is offset by the unrealized gain in the other leg of the straddle is a pattern usually found in the trading of tax straddles.

Straddle transactions having as their principal objective "deferrals" (postponing to a later year an already realized gain in an unrelated transaction) or "conversions" (changing a short-term capital gain on an unrelated transaction to a long-term capital gain) are commonly referred to as "tax straddles" in the industry.

A "butterfly straddle" is a straddle consisting of at least three legs. It is essentially a combination of two straddles that, when drawn schematically, resembles a butterfly. For example, the following would be a butterfly straddle with four legs:

Long March 1981 Long December 1981
Short July 1981
Short July 1981

The middle position or "body" of a butterfly straddle is exactly twice the size of each outside position or "wing." In a butterfly straddle, each straddle is traded separately and will usually have two different spread price differentials. Such a straddle typically presents less chance of either an adverse or a favorable spread movement, and hence is less likely to produce a difference loss or difference gain than an ordinary straddle. Furthermore, a butterfly straddle containing delivery months encompassing only a brief period (e.g., a May 1981/July 1981/September 1981 straddle) typically presents less chance

of loss or gain than a butterfly straddle spread over a longer period (e.g., March 1981/July 1981/December 1981 straddle).

It is generally understood that about 85 to 90 percent of trades in commodity futures result in losses. Nevertheless, there are opportunities for realizing profits in such trading, including trading in straddles. The use of a straddle tends to minimize the risk of loss, but at the same time, it reduces the opportunity for profit. This is true because every position held by one holder is matched by an exactly opposite position (or group or series of positions) held by one or more other holders. Thus, a loss realized by one holder on closeout will be matched by the realization of a gain in the same amount by the holder or holders of the opposite position, provided the opposite position was acquired at the same time and held to the closeout.

The Program Participated in by Petitioners

In late 1979 or early 1980, Avram Salkin (Salkin), a member of the law firm of Hochman, Salkin & DeRoy, Los Angeles, California, organized F.G. Hunter & Associates (Hunter) as a Nevada limited partnership for the purpose of operating a commodities brokerage firm. Subsequently, on February 20, 1980, Hunter was registered with the Commodities Futures Trading Commission (CFTC) as a Futures Commodity Merchant. As such, Hunter was authorized during 1980 and 1981 to execute trades for its customers through member brokers on Commodity Exchange, Inc. (COMEX). All of the transactions at issue in this case were executed on Hunter's behalf on COMEX by A. G. Becker, a member broker. COMEX has been designated a "board of trade" by CFTC, and futures contracts are regularly traded on COMEX on

weekdays pursuant to rules and regulations approved by CFTC. The mechanics of trading in commodity futures on COMEX is discussed in detail in *Smith v. Commissioner,* 78 T.C. 350 (1982), affd. without published opinion 820 F.2d 1220 (4th Cir. 1987).

Beginning in 1980, and continuing through 1981, Hunter was engaged in a promotion known as An Investment Program in Spreading the Gold Futures Market. A substantial portion of the materials used in the promotion was devoted to "certain technical services which should provide clients with some substantial tax benefits," and prospective investors had access to a brochure entitled "Spreading the Gold Futures Market," which contains the following claims:

By utilizing certain techniques which have been developed the client can reasonably expect to profit from both a cash and tax standpoint. This is not to imply that every client will make both a cash and tax profit. With any investment program the risk of loss is commensurate with the opportunities for profit. However, the opportunity for profit can be considerably enhanced and the risk of loss substantially reduced by taking advantage of the Company's tax saving techniques.

The price of gold can move up or down $100/oz. in a matter of months. If for example, a client invested $18,500 in 20 Gold Bull Spreads with the CFIR at 20% and the price of gold went up $100 and interest rates increased 4%, the client would make $14,680 cash profit and have an additional $114,120 of net ordinary losses to shelter other income. However, had the market gone against him in the above conditions, he would have lost $14,680 in cash and would have $134,680 of net ordinary losses to shelter other income.

In a section entitled "Questions and Answers on Gold Futures" the brochure provided the following information:

2. *How can I expect to gain?*

By wisely selecting the sequence of your long and short contracts, you may realize a substantial profit from a change in either the price of gold or generally prevailing interest rates.

3. *Can I lose my investment?*

Yes. As with any investment, the risk of loss is commensurate with the opportunities for pprofit. However, the opportunity for profit can be considerably enhanced, and the risk of loss is almost eliminated by our tax saving techniques.

* * * *

9. *How can the probability of gain be increased by choice of liquidation methods?*

Income tax treatment of your gains or losses on each contract will be different depending upon your tax bracket, your risk of after tax loss on both of these contracts will be very substantially reduced and will usually be converted into an after tax gain. Any net pre-tax profit will be significantly increased through tax savings. If you cancel the contract which is in the losing position you received (based on Tax precedents) an ordinary loss. If you sell or assign a short contract which shows a profit you receive Long Term Capital Gains (LTCG).

10. *Precisely how do I achieve LTCG and Ordinary Losses?*

(a) If there is a *gain* in your long position, you should *qualify* for *capital* gains treatment providing you have your contract for greater than six months, by going short in the same delivery month. F.G. Hunter will perform this service.

(b) If you have a gain in your *short* position you *could sell* it to an *unrelated third party* and qualify for capital gains treatment providing you have held your contract for greater than six months.

(c) If you have a *loss* in either your long or short position, you should *cancel* it. If you do, your loss will

be an ordinary loss rather than a capital loss. F.G. Hunter will perform this service.

11. *Can I sell a short futures contract?*

Your contract with F.G. Hunter & Associates has an assignment provision which facilitates its sale to a third party. The third party will probably want to buy your contract for a slight discount but this should not materially affect your results.

12. *Can I cancel a futures contract?*

Your contract with F.G. Hunter & Associates also has a cancellation provision. The cancellation charge would be equal to the difference between the then current market price of your contract and the original contract price, plus a cancellation charge of $25 per contract.

In a glossary, the brochure provided the following definitions of tax terms and examples of possible tax benefits:

(a) Capital Gain

(1) Long term: The holding period (length of ownership) for commodity futures contracts to achieve long term capital gains tax treatment is more than six months. For most other types of investments the required holding period is more than one year. Maximum tax is 28% for individuals in a 70% tax bracket and the maximum tax for a corporation is 28% for a corporation in a 46% tax bracket. Sixty percent of LTCG is excluded from taxation for individuals only.

(2) Short term: Ownership has been for less than six months for futures, and less than one year for most other investments. Maximum tax is 70% for individuals and 46% for corporations.

(b) Ordinary Loss

Is a loss that is deductible dollar for dollar against both earned (ordinary) and unearned (passive) income. There is no limit on the amount of loss which you can deduct in the current year. For example, if you have a $100,000 ordinary loss and a $100,000 long term capital gain you would have an actual cash profit of zero. However your

tax savings would be as follows:
Assume 50% tax bracket.

$100,000 Ordinary loss 100% deductable	-$100,000	
$100,000 LTCG × 40% taxable	40,000	Taxable gain
Net ordinary loss	-60,000	
	× 50%	Tax bracket
Tax savings	30,000	

(c) Carry Back and Carry Forward

An individual and a corporation can carry non-business ordinary losses back for three years and forward for seven years. However special rules apply to individuals regarding the carry back. Consult your tax advisor.

(d) Income

(1) Ordinary: Or earned income is the money you make from employment, salaries, wages, commissions, tips, bonuses, etc. Maximum rate is 50%.

(2) Passive: Or unearned income is generally the money you receive from investments i.e. dividends, rents, royalties, etc. Maximum rate is 70%.

(e) Cancellation

Any contract may be cancelled. Upon cancelling a contract both parties are returned to pre-contract position minus a cancellation fee of $25. The contract ceases to exist and no longer has any binding powers to any party. The cancellation of a contract gives rise to an ordinary loss or gain. (See tax opinion). You only cancel losing positions you never cancel winning positions.

(f) Assignment:

Sell or assign short futures contract to disinterested third party gives rise to long term capital gain if held six months or longer. You only assign or sell a short winning position never a long winning position.

A second brochure provided to prospective investors contained a further list of questions and answers, a few of whcih are as follows:

8. *How can the probability of gain be increased by choice of liquidation methods?*

Income tax treatment of your gains or losses on each contract will be different depending upon the way your contract is closed out. There are ways to close out a contract in which you have a gain so that it will be taxed as a long term capital gain. For the contract in which you have a loss, you may liquidate so as to have ordinary loss. Depending upon your tax bracket, your risk of after tax loss on both of these contracts will be very substantially reduced and will quite possibly be converted into an after tax gain. Any net pre-tax profit will be significantly increased.

* * * *

11. *Would the same results be realized with other choices of dates?*

The results that would have been achieved with other choices of dates would be different. However, the principles are the same if these conditions apply. (1) The contracts are closed out after the expiration of the six months capital gains holding period, (2) The contract on which you have a gain is closed out in a way which will qualify for capital gains tax treatment, and (3) the contract on which you have a loss is closed out in a way which will qualify for ordinary income tax treatment.

12. *Precisely how do I meet conditions (2) and (3) in question #11?*

If there is a gain in your long position, you should qualify for capital gains treatment by going short in the same delivery month. If you have a gain in your short position, you could sell it to an unrelated third party and qualify for capital gains treatment. If you have a loss in either your long or short contract, you should cancel it. If you do, your loss will be an ordinary loss rather than a capital loss.

Hunter's promotional materials also included a tax opinion issued by Hochman, Salkin & DeRoy which was

read and relied upon by each petitioner. The opinion, prepared by Salkin, described in detail, with citations to case law and statutes, the tax consequences which, in the opinion of the author, could be expected by investors from different methods of closing positions in straddles. In general, the opinion stated: (1) That if a profitable long futures contract was closed via offset, a long-term capital gain would result if the contract had been held for more than 6 months; (2) that if a profitable short futures contract was closed via offset, a short-term capital gain would result, even if the contract had been held for more than 6 months due to the special short sale rules contained in section 1233(b); (3) that if a profitable short futures contract was sold to an unrelated third-party via assignment, a long-term capital gain would result if the contract was held for more than 6 months; and (4) that if a losing long or short futures contract was canceled, no sale or exchange occurred and thus the loss would be an ordinary loss.

Each investor in the program was required by Hunter to sign an "Account Agreement" which provided in pertinent part:

Gentlemen:

In consideration of your accepting my account and your agreement to act as my broker, I agree to the following with respect to any of my accounts with you for the purchase and sale of commodities, purchases of commodities futures contracts, and sale and cancellation of commodities futures contracts:

1. * * *

2. Margin and Operation of Account. I agree to post such deposits and maintain such collateral and/or margin as you may in your discretion require from time to time and will pay on demand any amount owing with respect to any of my accounts.

A. If I hold a "short" position in any commodity contract, it is understood that I have the following options:

(1) To sell said contract through you on the open market.

(2) To furnish you with all necessary delivery documents as to enable you to make delivery thereof under the terms of the contract.

(3) To furnish you with all information and documents necessary for you to enact a transfer of my account or any individual position therein.

(4) I shall have the right to cancel said contract by paying to or receiving from you (i) the market price of said commodity contract as of the date that you receive notice of my intention to cancel, reduced by (ii) the contract price at which I would have been required to make delivery, reduced by (iii) a cancellation fee. Upon cancellation there shall be no further binding obligations on either party with respect to the cancelled contract.

(5) To instruct you to make a purchase of a contract for delivery of the same month as my short contract, which shall cause my short contract to be offset and thereby terminated.

B. With respect to any contract to purchase a given commodity at a given time, I shall have the right to cause any of the following to take place:

(1) Accept delivery of the commodity covered by said contract upon payment of the contract price in cash, or upon such terms as we may mutually agree.

(2) To instruct you to sell said contract prior to the date of delivery.

(3) To furnish you with all information and documents necessary for you to enact a transfer of my account or any individual position therein.

(4) To instruct you to make a short sale of a contract for delivery of the same commodity for the same month

as my contract to be offset and thereby terminated.

(5) I shall have the right to cancel said contract by paying to you or receiving from you an amount equal to the difference between (i) the original contract price, reduced by (ii) the market price of said contract as of the date of cancellation, reduced by (iii) a cancellation fee. Upon cancellation there shall be no further binding obligations on either party with respect to the cancelled contract.

Prospective investors including petitioners herein were required to submit account applications to Hunter and, upon their acceptance, were required to execute a standardized account agreement and risk disclosure (account agreement). As a general rule, each new investor also received from Hunter a separate risk disclosure statement and a document reflecting Hunter's current policies and fees. However, petitioners Arthur Toll and Richard B. Leavitt, through their partnership, C.D. Associates, entered into a separate letter agreement with Hunter covering commissions, margin requirements, fees, and other financial arrangements. All petitioners were generally familiar with Hunter's program and had access to and read Salkin's tax opinion.

After depositing sufficient funds with Hunter to meet their "margin requirements," as well as any applicable fees and commissions, a customer was permitted to commence trading with Hunter. To do this, the customer would advise Hunter of the position he desired with respect to gold futures. Hunter would then direct A.G. Becker by telephone to execute the order at COMEX. A.G. Becker, in turn, would execute the necessary transactions on the exchange floor at COMEX and confirm the transactions as between itself and Hunter. Hunter would then confirm the transactions with its client by

issuing a customer contract reflecting the client's position, price, and a time stamp, as well as a separate confirmation document which reflected the position, prices, margin, and commissions. After the client had reviewed and approved the transaction documents, the customer contract was signed by the client and by a Hunter representative.

To liquidate a position, an investor was counseled by Hunter as to whether he should offset, cancel, or assign his contracts. Hunter's fee for each type of transaction was as follows:

Offset	$10 per contract
Cancellation	25 per contract
Assignment	35 per contract

At the option of the investor, Hunter would charge an additional fee of $20 per spread which was paid by Hunter to the law firm of Hochman, Salkin & DeRoy for the legal defense of any tax loss reported by the investor.

If the customer was holding a contract containing a loss, Hunter would recommend cancellation and, with the customer's permission, Hunter would cancel the contract, assume the customer's position on the contract, establish an offset position to protect itself, and pay the customer the net cancellation price (the market value of the contract at the time of cancellation less the $25 cancellation fee, the $20 legal fee if any, and the $10 offset fee). Any gain or loss realized on the ultimate disposition of the contract would be pocketed or absorbed as the case might be by Hunter.

If the customer was holding a contract containing an unrealized gain, Hunter would assign the contract at a discount to R.A. Breckenridge, Inc. (Breckenridge), a trader in commodity futures. Hunter would pay its cus-

tomer the discounted price received from Breckenridge less the assignment fee of $35. Breckenridge would then terminate the contract on the floor of COMEX and retain the difference.

When any change in a position with a customer occurred, Hunter entered an appropriate notation in the applicable customer account indicating the type of transaction, price, gain or loss, and the date and hour of the transaction. Hunter also regularly issued monthly and annual statements to its customers reflecting the status of their accounts.

Philip Ewing and His Participation

Philip Ewing (Ewing) graduated from Ohio State University in 1943 with a bachelor of science degree in business administration and received a master's degree in business administration from Harvard University in 1948. Throughout the years in issue, he was the president and part owner of a corporate hardware manufacturer. Prior to 1980, he had been involved in a number of investment activities both for his own account and as an investment manager for others. He regarded Hochman, Salkin & DeRoy as a credible law firm and relied upon their opinion in formulating his investment decisions.

Complete details with respect to Hunter's transactions for Ewing during the years 1980 and 1981 are set out in Appendix I, and only a brief synopsis is needed here. By reference to Appendix I, it will be noted that on December 5, 1980, Hunter initiated a series of straddle trades for Ewing in gold futures that continued into 1982. Throughout the series of trades, a balanced position (i.e., an equal number of long and short contracts) was maintained for Ewing although the long and short contracts

were for different delivery months. At the beginning (December 5, 1980) his position in the market (20 Short Feb. '82 and 20 Long Apr. '82) was essentially a 2-month bull spread, i.e., a spread which would be expected to yield a profit in a bull market as contrasted with a bear spread which would be expected to yield a profit in a bear market. In a bull spread, the near contract is short and the far contract is long because historically the long contract will gain on the short in such a spread. Generally speaking, in a bear spread the contracts are reversed, and the short contract should gain on the long. See *Smith v. Commissioner,* 78 T.C. at 355.

Five days later, on December 10, 1980, the 20 Long Apr. '82 contracts were canceled and replaced by 20 Long Dec. '81 contracts. As a consequence of this switch, a trading "loss" of $104,800 was purportedly realized in 1980 on the cancellation of the 20 Long Apr. '82, but the spread was immediately reconstituted as a 2-month bear spread of 20 Long Dec. '81 and 20 Short Feb. '82.

For Ewing, Hunter elected to conduct futures trading in "very thin markets." That is, the delivery months in the contracts selected were so distant on the date of purchase that trading in them at that time was relatively inactive. This is illustrated by the original bull spread where the near leg of the spread was 14 months away from the initial trade date, December 5, 1980, and the distant leg was 16 months away. After the switch from the bull spread to the bear spread, the near and distant legs were, respectively, 12 and 14 months away.

On February 11, 1981, Ewing executed another switch by canceling 10 of his Dec. 81 Long contracts (acquired on December 10, 1980) and acquiring 10 Apr. '82 Long

contracts. Consequently, at the close of trading on February 11, 1981, Ewing's position in the market amounted to a buttrefly spread as follows:

10 Long Dec. '81 10 Long Apr. 82

20 Short Feb. '82

During the remainder of 1981, Hunter executed a series of transactions for Ewing, which altered his position from a butterfly spread to a bear spread and back again to a butterfly spread.

As a result of his futures transactions, Ewing claimed ordinary losses of $107,563 and $116,096 in 1980 and 1981, respectively, comprised of the following:

	1980	1981
Trading losses	$104,800	$114,900
Commissions	1000	500
Cancellation fees	1,763	696
Total	107,563	116,096

Substantially all of the short contracts were liquidated at gains via "assignments" during 1981 after having been held a minimum of 6 months and were reported by Ewing as long-term capital gains on his 1981 return.

Toll and Leavitt and Their Participation

Arthur Toll (Toll) received a bachelor of arts degree in 1948 and a law degree in 1950 from Case Western Reserve University in Cleveland, Ohio. He has practiced corporate securities law since 1961 and has maintained an active securities account with Shearson American Express since 1977. Richard B. Leavitt (Leavitt) graduated from Dartmouth College in 1957 with a bachelor of arts degree and received a law degree from Stanford University in 1960. He has actively invested in securities since 1960.

At all relevant times, Toll and Leavitt were principals in the law firm of Toll & Leavitt. They were also limited partners in a partnership known as C.D. Associates (C.D.) and conducted their transactions with Hunter through C.D.

C.D. was organized as a California limited partnership on or about June 14, 1980, for the exclusive purpose of trading in commodity futures. Its general partner was H & S Investments (H & S), a general partnership. At all relevant times, H & S Investments was a partnership comprised of Mr. and Mrs. Bruce I. Hochman, Mr. and Mrs. Avram Salkin, and certain revocable living trusts of which these individuals were the trustees and beneficiaries. On or about December 3, 1980, H & S was licensed by the CFTC as a Commodity Operator and as a Commodity Trading Advisor. C.D.'s operations and trading activities were managed by Salkin with some indirect involvement by Bruce Hochman.

Prior to the formation of C.D., Salkin invited some of the clients of his firm to a meeting where he disclosed, discussed, and explained a contemplated investment program in gold futures. Toll and Leavitt attended the meeting and ultimately decided to participate in the program because they knew and respected Salkin, relied upon his opinion, and had dealt with his law firm for over 10 years. At the meeting, they were informed by Salkin that there would be "good tax treatment" with respect to an investment as limited partners in C.D., the partnership which was being formed to handle the contemplated transactions in gold futures. Toll and Leavitt each invested $37,500 in C.D. and became limited partners therein on June 19, 1980.

The details of C.D.'s transactions in gold futures are

set out in Appendix II, and only a brief synopsis will be provided here. On June 18, 1980, Salkin initiated for C.D. a series of straddle trades in gold futures that continued into 1981. Throughout the series of transactions made during 1980, Salkin maintained a substantially balanced position, i.e., an equal number of long contracts and short contracts, plus a few extra short contracts over and above the long contracts. This practice is illustrated by C.D.'s position in the market on June 18, 1980, which was essentially that of a 6-month bull spread, i.e., 175 Short Oct. '81 contracts balanced against 175 Long Apr. '82 contracts, with an extra 9 Oct. '81 Short contracts. Salkin's stated purpose for the additional 9 short contracts over long contracts was an attempt to neutralize the gain or loss from changes in gold prices, and to limit the gain or loss in the position to fluctuations in interest rates. In other words, it was an attempt to prevent, as nearly as possible, the market forces from having any impact upon C.D.'s position.

On June 30, 1980, Salkin liquidated by cancellation with Hunter a number of C.D.'s short positions for one delivery month and purchased a nearly equivalent number of short positions for a different delivery month. These switches were made in order to realize tax losses for 1980. After the switches, C.D.'s account still constituted a bull spread but the legs of the spread were placed closer together, i.e., the initial 6-month spread was replaced with a 2-month spread. In economic terms, all that the switching accomplished for C.D. was to incur additional transaction costs (commissions and cancellation fees) since the reconstituted bull spread actually offered a lower profit potential than the preceding spread. Substantially all of C.D.'s profitable contract positions were held a minimum

of 6 months before liquidation via "assignment" in 1981 in order to acquire long-term treatment for the gains.

C.D.'s partnership return for 1980 was prepared in accordance with the partnership's books and records with professional assistance from Salkin concerning the reporting and treatment of the partnership's transactions in gold futures. The partnership reported an ordinary loss in 1980 comprised of the following:

Trading losses	$3,063,316
Commissions	15,541
Cancellation fees	13,925
Total losses	3,092,782

Toll and Leavitt each reported an ordinary loss in 1980 in the amount of $103,835 as their distributive shares of C.D.'s losses.

Czarneski and Leong and Their Participation

Don A. Czarneski (Czarneski) graduated from Memphis State University in 1966 with a bachelor of science degree in business administration. From 1966 through 1980, he was employed at different times by Union Camp Corp., Weyerhaeuser Corp., Paragon Securities, AS Hart Securities, and Coldwell Banker. At the time of trial, he was an associate vice president in Coldwell Banker's Commercial Real Estate Division in Houston, Texas.

Richard W. Leong (Leong) graduated from Linfield College in McMinnville, Oregon, in 1942. He was a certified and practicing orthopedic surgeon from 1953 up to and throughout the years in issue.

On June 30, 1980, Czarneski and Leong through Hunter initiated a series of independent butterfly straddle trades in gold futures similar to those entered into by Ewing. Throughout the series of straddle trades, Czarneski

and Leong both maintained balanced positions. The details and chronology of Czarneski's and Leong's futures transactions for the taxable years 1980 and 1981 are more thoroughly set forth in Appendix III and Appendix IV, respectively. Cancellations were utilized in both of their trading accounts during 1980 and 1981 in order to realize purported tax losses in the losing legs of their straddles, and switches were employed to offset and protect their profitable positions in the other legs of their straddles for a minimum of 6 months when the purported positions were liquidated via assignments.

On their returns for the taxable years 1980 and 1981, Czarneski and Leong claimed deductions for the following ordinary losses:

	1980	1981
Czarneski	$227,400	$359,600
Leong	35,000	198,200

In addition to the above losses for 1981, Czarneski claimed a deduction of $3,000 and Leong a deduction of $2,500 for "investment advisory services" paid to Hunter in connection with their futures trading. In 1981, they reported long-term capital gains of $586,700 and $234,500, respectively, from the assignment of gold futures contracts.

OPINION

(1) *Losses on Straddle Transactions*

The primary issue in these cases is whether petitioners, investors as opposed to dealers, are entitled to deduct losses on straddle transactions as claimed on their income tax returns for 1980 and 1981. Resolution of the issue turns on the effect of section 108 of the Tax Reform Act of 1984 (Division A of the Deficit Reduction Act of

1984), Pub. L. 98-369, 98 Stat. 494, 630, as amended by section 1808(d) of the Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2817. Hereinafter, our references to "section 108" are to the Tax Reform Act of 1984, as amended, unless otherwise stated.

By notices of deficiency, respondent determined that petitioners' straddle losses are not deductible under section 165(c)(2) because the transactions were not entered into for profit. Relying on the primary for-profit test applied in our decisions in *Fox v. Commissioner*, 82 T.C. 1001 (1984), and *Smith v. Commissioner*, 78 T.C. 350 (1982), affd. without published opinion 820 F.2d 1220 (4th Cir. 1987), respondent argues that petitioners did not enter into the straddle transactions primarily for profit, but instead their primary motive was to obtain tax benefits. Respondent does not argue and we have not found that these transactions are "shams in substance" (see *Glass v. Commissioner*, 87 T.C. 1087 (1986)), or that they are "factual shams" (see *Brown v. Commissioner*, 85 T.C. 968 (1985)), affd. sub nom. *Sochin v. Commissioner*, 843 F.2d 351 (9th Cir. 1988).

Petitioners, on the other hand, submit that their dealings in gold futures were bona fide transactions entered into for profit and, therefore, their losses are deductible under section 165(c)(2). They argue that the profit standard of former section 108 as set forth in our decision in *Miller v. Commissioner*, 84 T.C. 827 (1985), revd. 836 F.2d 1274 (10th Cir. 1988), applies to their transactions, and that they have carried their burden of proving that the transactions were entered into with a reasonable expectation of profit. It should be noted that these cases were tried and originally briefed before section 108 was amended by section 1808(d) of the Tax Reform Act of

1986. However, at our request, the parties filed supplemental briefs after section 108 was amended but before *Miller v. Commissioner,* 84 T.C. 827 (1985), was reversed by the 10th Circuit, 836 F.2d 1274 (10th Cir. 1988).

In *Miller,* we construed the original version of section 108[5] and concluded that Congress did not intend to adopt the historical subjective test of section 165(c)(2), i.e., primary motivation, for purposes of determining pre-1982 straddle loss deductions. Persuaded in part by the legislative history of former section 108, we adopted in *Miller* an objective profit standard which could be satisfied with a showing that at the time the transaction was entered into there was a reasonable expectation of profit. 84 T.C. at 838-842. Following the lead of our decision in *Miller,*

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5. The original version of sec. 108 provided, in pertinent part:

SEC. 108(a). GENERAL RULE.—For purposes of the Internal Revenue Code of 1954, in the case of any disposition of 1 or more positions—

(1) which were entered into before 1982 and form part of a straddle, and

(2) to which the amendments made by title V of the Economic Recovery Tax Act of 1981 do not apply, any loss from such disposition shall be allowed for the taxable year of the disposition if such position is part of a transaction entered into for profit.

(b) PRESUMPTION THAT TRANSACTION ENTERED INTO FOR PROFIT.—For purposes of subsection (a), any position held by a commodities dealer or any person regularly engaged in investing in regulated futures contracts shall be rebuttably presumed to be part of a transaction entered into for profit.

(c) NET LOSS ALLOWED WHETHER OR NOT TRANSACTION ENTERED INTO FOR PROFIT.—If any loss with respect to a position described in paragraphps (1) and (2) of subsection (a) is not allowable as a deduction (after applpying subsections (a) and (b)), such loss shall be allowed in determining the gain or loss from dispopsitions of other positions in the straddle to the extent required to accurately reflect the taxpayer's net gain or loss from all positions in such straddle. [Tax Reform Act of 1984, Pub. L. 98-369, sec. 108, 98 Stat. 630.]

the Ninth Circuit subsequently concluded that former section 108 required the investor to have only a reasonable expectation of a profit. *Wehrly v. United States,* 808 F.2d 1311, 1312 (9th Cir. 1986); accord *Landreth v. Commissioner,* 845 F.2d 828 (9th Cir. 1988), affg. a Memorandum Opinion of this Court. However, in *Miller v. Commissioner,* 836 F.2d 1274 (10th Cir. 1988), the Tenth Circuit rejected our reasonable expectation of a profit test and concluded that the proper test was the primary motive of the taxpayer upon entering into the transaction.

To further complicate the situation, after our opinion in *Miller* was released but before it was reversed by the Tenth Circuit, former section 108 was amended retroactively by section 1808(d) of the Tax Reform Act of 1986.[6] By the amendment, Congress obviously attempted to harmonize the language of section 108 with that in section 165(c)(2). See *Glass v. Commissioner,* 87 T.C.

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6. Sec. 1808(d) of the Tax Reform Act of 1986 amended sec. 108 as follows:

(d) SECTION 108.—Section 108 of the tax reform act of 1984 is amended—

(1) by striking out "if such position is part of a transaction entered into for profit" and inserting in lieu thereof "if such loss is incurred in a trade or business, or if such loss is incurred in a transaction entered into for profit though not connected with a trade or business",

(2) by striking out subsection (b) and inserting in lieu thereof the following:

"(b) LOSS INCURRED IN A TRADE OR BUSINESS.—For purposes of subsection (a), any loss incurred by a commodities dealer in the trading of commodities shall be treated as a loss incurred in a trade or business.",

(3) by striking out the heading for subsection (c) and inserting the following:

'(c) NET LOSS ALLOWED.—", * * *

[Sec. 1808(d), Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2817.]

1087, 1167 (1986). Consequently, upon futher consideration we have recently concluded that the phrase "transaction entered into for profit" as used in amended section 108 is to be interpreted by reference to the subjective primary purpose standard historically applied to losses arising under section 165(c)(2). *Boswell v. Commissioner,* 91 T.C. 151 (1988).

Thus, with the exception of Toll and Leavitt, petitioners in these cases must show that their primary purpose for entering into the straddle transactions was for profit. Since Toll and Leavitt were limited partners in C.D., the deductibility of their losses from the straddle transactions has to be determined at the partnership level. See *Brannen v. Commissioner,* 78 T.C. 471, 505 (1982), affd. 722 F.2d 695 (11th Cir. 1984); *Siegel v. Commissioner,* 78 T.C. 659, 698 (1982). Therefore, the proper focus with respect to their losses is on the intent of the general partners of C.D., Salkin, and Hochman. See *Resnick v. Commissioner,* 66 T.C. 74 (1976), affd. per curiam 555 F.2d 634 (7th Cir. 1977).

As stated in *Glass,* the effect of adopting the test applicable to section 165(c)(2) for purposes of section 108 is to revalidate the historical profit standard set forth in *Fox v. Commissioner,* 82 T.C. 1001 (1984), and *Smith v. Commissioner,* 78 T.C. 350 (1982), affd. without published opinion 820 F.2d 1220 (4th Cir. 1987). Consequently, it is to *Fox* and *Smith* that we turn for guidance in the cases before us even though an appeal in docket numbers 3896-84, 13442-84, and 13443-84 would be to the Court of Appeals for the Ninth Circuit, the author of the decisions to the contrary in *Wehrly v. United States, supra,* and *Landreth v. Commissioner, supra,* because both *Wehrly* and *Landreth* arose under

section 108 before it was amended. *Golsen v. Commissioner,* 54 T.C. 742, 756-758 (1970), affd. 445 F.2d 895 (10th Cir. 1971). Furthermore, the precedential value of *Wehrly* and *Landreth* is seriously reduced, if not eliminated, by the statements of the panel in *Landreth* that "we believe that Congress, in enacting the 1986 amendments to section 108, clearly intended to overrule the Tax Court in *Miller* and to clarify that the 'entered into for profit' language in section 108 should be interpreted in the same way as the identical language in section 165 (c)(2)—namely as allowing taxpayers to deduct losses from straddle transactions only if they can show that their primary motive for entering into the transactions was economic profit" and that "all members of this panel believe that *Wehrly* was incorrectly decided."

In *Fox,* we concluded that section 165(c)(2) requires that profit be the primary motive if a loss from a particular straddle transaction is to be deductible. 82 T.C. at 1021. We acknowledged that profit need not be the sole motive, but emphasized that a mere incidental profit motive would not be sufficient. 82 T.C. at 1018, citing *Ewing v. Commissioner,* 20 T.C. 216, 233 (1953), affd. 213 F.2d 438 (2d Cir. 1954). In determining whether a straddle transaction is entered into primarily for profit, *Fox* provides the following additional guidelines:

(1) The ultimate issue is profit motive and not profit potential. However, profit potential is a relevant factor to be considered in determining profit motive. 82 T.C. at 1021.

(2) Profit motive refers to economic profit independent of tax savings. 82 T.C. at 1022.

(3) The determination of profit motive must be made with reference to the spread positions of the straddle and not merely to the losing legs, since it is the overall scheme which determines the deductibility or nondeductibility of the loss. 82 T.C. at 1018, citing *Smith v. Commissioner*, 78 T.C. at 390-391.

(4) If there are two or more motives, it must be determined which is primary, or of first importance. The determination is essentially factual, and greater weight is to be given to objective facts than to self-serving statements characterizing intent. 82 T.C. at 1022.

(5) Because the statute speaks of motive in "entering" a transaction, the main focus must be at the time the transactions were initiated. However, all circumstances surrounding the transactions are material to the question of intent. 82 T.C. at 1022.

In the cases before us, as in *Fox*, we proceed on the supposition without so finding that petitioners had a sincere belief that there was a possibility of making some profit from their transactions and were attracted to the transactions by this prospect as well as by the favorable tax benefits. We must determine, however, which of these motives was primary, or of first importance, with the burden of proof being on petitioners. Rule 142.

From the record as a whole, we are convinced that petitioners did not enter into their straddle transactions primarily for profit for the reasons discussed below.

First, the principal thrust of Hunter's promotional material was the availability of the closing procedures by cancellation and assignment and the favorable income tax consequences allegedly associated with such procedures. This is particularly apparent from Salkin's 23-page

tax opinion, which is the most influential item in the promotional materials, and the item which all petitioners admittedly read. In contrast to the favorable tax benefits, the profitability of the program was not seriously discussed or quantified.

Second, the trading by or for petitioners demonstrates more interest in the tax advantages purportedly made available by the alternative closing procedures than in profits. This is clear from our finding that petitioners frequently held positions during the years in issue which tended to minimize rather than to maximize profits in "thin markets" with low volume trading and where the temporal difference between delivery months was so close as to leave virtually no time for market movements in gold prices or short-term interest rates to affect net profits. Furthermore, each petitioner chose to "cancel" the initial losing legs of his straddles before the close of the 1980 tax year so as to generate an ordinary loss. In the following year, substantially all of the profitable legs of the straddles were assigned in order to generate long-term gains. As a consequence, petitioners were able to offset their 1980 ordinary income from wages, dividends, interest, rents, and partnerships with ordinary losses from the cancellation of their gold futures transactions. By closing out the profitable legs of their straddle positions in 1981 by means of the assignments, petitioners not only deferred their straddle gains to 1981 but also effectively converted 1980 ordinary income into 1981 long-term capital gains.

Third, the so-called "alternative liquidation techniques," (i.e., cancellations and assignments) described hereinbefore were devised and adopted by Hochman, Salkin & DeRoy as part of a program to assist Hunter to sell pros-

pective investors on a scheme to achieve tax avoidance. However, to ultilize these techniques, petitioners paid more commissions and fees than they would have incurred if their positions had been closed in the usual manner. Petitioners were willing to incur the extra cost, however, in order to obtain the beneficial tax consequences as illustrated by Ewing's testimony as follows:

There was a tax consequence to the way in which you got out of your positions. One of the consequences is that if it's a losing position it could have been cancelled * * * or liquidated at a greater cost than if you offset, but it had some tax advantages—which were openly stated up front. * * *

Fourth, the transactions were entered into for the specific purpose of generating tax losses as revealed in the following excerpt from Salkin's testimony:

Q. Okay, Mr. Salkin, prior to June 18—prior to the time that the first trade in the C.D. Account was ever made, wasn't it contemplated that you would switch certain—certain of the losing legs of the gold futures spreads to achieve a loss to this—close to this amount?

A. No, there was no specific target, and there were no specific contracts that were earmarked for trading.

Q. Did you have a specific idea of a tax loss that you wanted as a result of these trades?

A. Yes.

Q. How much was that? What was it?

A. Approximately double the amount of capital.

* * * * * * *

Q. For what purpose?

A. That—That was my general target, a—that I had the profit target of 20 percent per annum, and I had a tax loss target the first year of approximately double the capital.

This testimony by Salkin, one of the principal organizers of Hunter, a general partner in C.D., and the individual primarily responsible for placing all petitioners in the program is particularly telling as to their intent. Furthermore, under the circumstances, we find it impossible to believe that Salkin did not discuss these loss targets with each petitioner.

From all of the above, we are satisfied that petitioners' motives in entering into these transactions, despite their protestations to the contrary, were primarily to obtain tax advantages and not for profits. In reaching this conclusion, we are cognizant of the fact that tax planning is an economic reality in the business world and the effect of tax laws on a transaction is routinely considered along with other factors, but nevertheless we reiterate that "tax straddling * * * transactions can hardly be said to number among congressionally approved, sanctioned, or encouraged responses to the tax laws." *Fox v. Commissioner*, 82 T.C. 1001, 1025 (1984).

Since petitioners' transactions were not entered into primarily for profit, their straddle loss deductions are not allowable under section 165(c)(2) and section 108(a). However, section 108(c) provides that:

> If any loss with respect to a position described in paragraphs (1) and (2) of subsection (a) is not allowable as a deduction (after applying subsections (a) and (b)), such loss shall be allowed in determining the gain or loss from dispositions of other positions in the straddle to the extent required to accurately reflect the taxpayer's net gain or loss from all positions in such straddle. [Tax Reform Act of 1984, Pub. L. 98-369, sec. 108, 98 Stat. 630, as amended by sec. 1808(d) of the Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2817.]

Section 1.165-13T, Temporary Income Tax Regs., 49 Fed. Reg. 33445 (Aug. 23, 1984) further amplifies section 108(c) to provide, in pertinent part:

> Q-3. If a loss is disallowed in a taxable year (year 1) because the transaction was not entered into for profit, is the entire gain from the straddle occurring in a later taxable year taxed?
>
> A-3. No. Under section 108(c) of the Act the taxpayer is allowed to offset the gain in the subsequent taxable year by the amount of loss (including expenses) disallowed in year 1.

In each of these cases, the petitioner claimed loss deductions in 1980 (year 1) with respect to a straddle position or positions, but in 1981 (year 2) reported long-term capital gains from the straddle transactions. Petitioners, therefore, are entitled to offset their gains in 1981 by any losses that are not allowable in 1980 under section 108(a). Sec. 108(c); sec. 1.165-13T, Q & A-3, Temporary Income Tax Regs.; cf. *Glass v. Commissioner*, 87 T.C. 1087, 1177 (1986), where the straddle transactions were a sham and gains reported in year two were held not to constitute taxable income.

(2) *Fees Paid With Respect to Straddles*

Inasmuch as we found that petitioners entered into their straddle transactions primarily to obtain tax deductions, the fees paid by petitioners constituted payments to purchase such deductions and are nondeductible personal expenditures. *Brown v. Commissioner*, 85 T.C. 968 (1985), affd. sub nom. *Sochin v. Commissioner*, 843 F.2d 351 (9th Cir. 1988); *Zmuda v. Commissioner*, 79 T.C. 714 (1982), affd. 731 F.2d 1417 (9th Cir. 1984); *Houchins v. Commissioner*, 79 T.C. 570 (1982). See also *Falsetti v. Commissioner*, 85 T.C. 332 (1985).

(3) *Additions to Tax*

In amended answers, respondent seeks increased interest from each petitioner pursuant to section 6621(c). Respondent has the burden of proof with respect to the additional interest. *Zirker v. Commissioner,* 87 T.C. 970, 981 (1986). Rule 142(a).

The increased interest provided by section 6621(c) is properly asserted where respondent has established that there is a "substantial underpayment" (an underpayment of at least $1,000) in any taxable year "attributable to 1 or more tax motivated transactions." The additional interest accrues after December 31, 1984, even though the transaction was entered into prior to the date of enactment of section 6621(c). *Solowiejczyk v. Commissioner,* 85 T.C. 552, 555-557 (1985), affd. without published opinion 795 F.2d 1005 (2d Cir. 1986); *Neely v. Commissioner,* 85 T.C. 934 (1986). Petitioners request that we reconsider our conclusion in *Neely* and *Solowiejczqk* and hold that section 6621(c) applies only with repect to returns filed after enactment of the Tax Refom Act of 1984. However, this argument was specifically addressed and rejected in *Solowiejczyk* and will not be reconsidered here.

Section 6621(c)(3)(A)(iii) specifically includes any straddle as a tax-motivated transaction. Thus, petitioners' transactions are clearly within the purview of section 6621(c). Moreover, section 6621(c)(3)(B) gives the Secretary of the Treasury authority, by regulation, to add to the categories of transactions that under section 6621 (c) will be treated as tax-motivated transactions. Under that grant of authority the Secretary has promulgated section 301.6621-2T, Temporary Proced. & Admin. Regs., T.D. 7998, 49 Fed. Reg. 50391 (Dec. 28, 1984), 1985-

1 C.B. 368, which includes in tax-motivated transactions any underpayment attributable to a deduction disallowed under section 165(c)(2). Sec. 301.6621-2T, Q & A-4, Temporary Proced. & Admin. Regs. We have previously used this regulation as a guide in similar situations. See, e.g., *Patin v. Commissioner*, 88 T.C. 1086, 1129 (1987); *Helba v. Commissioner*, 87 T.C. 983, 1015 (1986); *Stanley Works and Subsidiaries v. Commissioner*, 87 T.C. 389, 420-421 (1986).

We have found that petitioners' straddle transactions were not entered into for profit. Consequently, any underpayment of tax by any petitioner which is based on a claimed straddle loss is attributable to a tax-motivated transaction and subject to the additional interest provided by section 6621(c). Sec. 6621(c)(3)(A)(iii); sec. 6621(c)(3)(B); sec. 301.6621-2T, Q & A-4, Temporary Proced. & Admin. Regs.

In his statutory notices, respondent determined that additions to tax are due from petitioners Ewing, Leong, and Czarneski for negligence under section 6653(a)(1), or where applicable, section 6653(a)(2). Respondent also determined that additions to tax are due from petitioners Leong and Czarneski for that portion of their underpayments which is attributable to negligence under section 6653(a)(2) for 1981. Petitioners have the burden of proof with respect to these determinations. *Welch v. Helvering*, 290 U.S. 111 (1933). Rule 142(a).

In amended answers, respondent asserted that petitioners Toll and Leavitt are also liable for additions to tax for negligence under section 6653(a)(1) and that Ewing is liable for an addition to tax on that portion of his underpayment which is attributable to negligence under section 6653(a)(2). Respondent has the burden of proof with

respect to the additions to tax asserted in the amended answers. Rule 142(a).

Before entering into the Hunter program, all petitioners read and relied upon a tax opinion provided by the law firm. Furthermore, at least two of them, Toll and Leavitt, had known and successfully dealt with Salkin, the author of the opinion, for over 10 years. Under the circumstances of this record, petitioners' reliance in good faith on the attorneys to formulate and implement the plan was not unreasonable or negligent. See *Sammons v. Commissioner*, 838 F.2d 330 (9th Cir. 1988), affd. in part and revg. in part a Memorandum Opinion of this Court.

We conclude, therefore, that petitioners' underpayments of tax were not due to negligence or intentional disregard of rules and regulations, and the additions to tax under section 6653(a)(1) and 6653(a)(2) are not sustained.

(4) *Damages Under Section 6673*

At the conclusion of trial, respondent moved for an award of damages under section 6673 against each petitioner for instituting and maintaining a proceeding before the Tax Court primarily for delay or which was based upon frivolous or groundless positions. We are well aware that transactions involving commodity straddles are extremely complicated and, during the years under consideration, were relatively new. Furthermore, from the time the petitions were filed in these cases up to and for some time after the date of trial, the law with respect to tax straddles was uncertain. See *Miller v. Commissioner*, 84 T.C. 827 (1985), revd. 836 F.2d 1274 (10th Cir. 1988); *Forseth v. Commissioner*, 85 T.C. 127 (1985), affd. 845 F.2d 746 (7th Cir. 1988), affd. *Mahoney v. Commissioner*,

808 F.2d 1219 (6th Cir. 1987), affd. *Bramblett v. Commissioner,* 810 F.2d 197 (5th Cir. 1987), affd. *Enrici v. Commissioner,* 813 F.2d 293 (9th Cir. 1987), affd. *Woolridge v. Commissioner,* 800 F.2d 266 (11th Cir. 1986); and *Julien v. Commissioner,* 82 T.C. 492 (1984). Consequently, and in the exercise of our discretion, we decline to award damages under section 6673.

To reflect the foregoing, and the concessions made by the parties,

Decisions will be entered under Rule 155.

UNITED STATES TAX COURT
Washington, D.C. 20217

DON A. CZARNESKI, and LYNNE C. CZARNESKI,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 14511-84

F.G. HUNTER

ORDER

In this case, which was consolidated with four other dockets,[1] our opinion [*Ewing v. Commissioner,* 91 T.C. 396 (1988)] was originally entered on August 30, 1988, and revised in certain minor particulars by order dated dated June 29, 1989. On appeal by all petitioners to the Court of Appeals for the Ninth Circut, petitioner Lynne C. Czarneski, asserted for the first time a claim that she is entitled to a new trial because of conflicts of interest by

1. Consolidated with 3896-84, 13442-84, 27900-84, and 13443-84.

her attorneys. The Court of Appeals did not address her new claim because it was not raised in this Court and affirmed our judgment against her, her ex-husband, and four other petitioners. *Toll, et al. v. Commissioner,* 940 F. 2d 1536 (9th Cir. 1991), affg. without opinion *Ewing v. Commissioner, supra.* The Appellate Court noted, however, that its "affirmance of the judgment against [Lynne C. Czarneski] is not intended to preclude her rights, if any, to raise her claims of conflict before the tax court." The Appellate Court also noted as follows:

> If Ms. Czarneski did not discover the grounds for her new trial claim until after the appeal in this case was filed, that still does not allow her to raise the issue for the first time on appeal. Although filing a notice of appeal divests a trial court of jurisdiction to dispose of a motion for reconsideration or vacation, the proper remedy in that case is to ask the tax court to indicate whether it wishes to entertain the motion and, if the court indicates it will, ask the appellate court to remand to the trial court so that the proper order may be entered. *Smith v. Lujan,* 588 F.2d 1304, 1307 (9th Cir. 1979) (deciding the issue in the context of Fed. R. Civ. P. 60(b), which governs how a party should seek relief from a final judgment of a federal trial court). [*Toll v. Commissioner, supra,* fn. 5.]

Pursuant to the above suggestion by the Appellate Court petitioner Lynne C. Czarneski has filed in this Court a motion to Vacate or Revise Decision and a Motion for Reconsideration of Findings or Opinion.

Inasmuch as the case was not remanded and since this Court has only such jurisdiction as is conferred upon it by

statute and does not have jurisdiction to exercise the broad common law concepts of judicial power invested in courts of general jurisdiction by Article III of the constitution, we are unable to decide an issue in the context of Fed. R. Civ. P. 60(b). See *Handeland v. Commissioner*, 519 F.2d 327, 329 (1975); *Burns, Stix, Friedman & Co. v. Commissioner*, 57 T.C. 392, 396 (1971). See also *Commissioner v. McCoy*, 484 U.S. 3, 6 (1987). However, from our review of petitioner's motions we are satisfied that an evidentiary hearing by this Court on petitioner's motions would be in order if the Court of Appeals sees fit to remand.

After due consideration of the opinion rendered in this matter by the Court of Appeals for the Ninth Circuit, it is

ORDERED that the Clerk shall forthwith transmit to the U.S. Court of Appeals for the Ninth Circuit for inclusion in the record a certified supplemental record consisting of this Order.

By: /s/ PERRY SHIELDS
Perry Shields
Judge

Dated: Washington, D.C.
December 13, 1991

U.S. CONSTITUTION—Amendment V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any

criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

INTERNAL REVENUE CODE

§ 7452. *Representation of parties*

The Secretary shall be represented by the Chief Counsel for the Internal Revenue Service or his delegate in the same manner before the Tax Court as he has heretofore been represented in proceedings before such Court. The taxpayer shall continue to be represented in accordance with the rules of practice prescribed by the Court. No qualified person shall be denied admission to practice before the Tax Court because of his failure to be a member of any profession or calling.

§ 7453. *Rules of practice, procedure, and evidence*

Except in the case of proceedings conducted under section 7463, the proceedings of the Tax Court and its divisions shall be conducted in accordance with such rules of practice and procedure (other than rules of evidence) as the Tax Court may prescribe and in accordance with the rules of evidence applicable in trials without a jury in the United States District Court of the District of Columbia.

§ 7482(c). *Powers.*—

(1) *To affirm, modify, or reverse.*—Upon such review, such courts shall have power to affirm or, if the decision of the Tax Court is not in accordance with law, to modify or to reverse the decision of the Tax Court, with or without remanding the case for a rehearing, as justice may require.

TAX COURT RULES OF PRACTICE AND PROCEDURE

Rule 201. *Conduct of Practice Before the Court*[1]

(a) *General:* Practitioners before the Court shall carry on their practice in accordance with the letter and spirit of the Model Rules of Professional Conduct of the American Bar Association.

RULE 3.7, AMERICAN BAR ASSOCIATION
Model Rules of Professional Conduct

(a) A lawyer shall not act as advocate at a trial in which the lawyer is likely to be a necessary witness except where:

(1) the testimony relates to an uncontested issue;

(2) the testimony relates to the nature and value of legal services rendered in the case; or

(3) disqualification of the lawyer would work substantial hardship on the client.

(b) A lawyer may act as advocate in a trial in which another lawyer in the lawyer's firm is likely to be called as a witness unless precluded from doing so by Rule 1.7 or Rule 1.9.

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1. The amendments are effective as of July 1, 1990.

91-1177

(2)

Supreme Court, U.S.
FILED
JAN 17 1992
OFFICE OF THE CLERK

NO. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

LYNNE C. CZARNESKI,
Petitioner
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

SUPPLEMENTAL APPENDIX TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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January 17, 1992

2

NOT FOR PUBLICATION
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

DON A. CZARNESKI; LYNNE C. CZARNESKI; RICHARD W. LEONG; JUNE D. LEONG,	)	No. 90-70444
	)	Tax Ct. No. 14511-84
Petitioner	)	
	)	ORDER
v.	)	
COMMISSIONER INTERNAL REVENUE SERVICE	)	
Respondent	)	

BEFORE: REINHARDT and FERNANDEZ, Circuit Judges, and CROCKER, District Judge*.

The panel has unanimously voted to deny the petition of Lynne C. Czarneski for rehearing. The suggestions of Lynne C. Czarneski for rehearing en banc was circulated to the active judges of the court, and no judge requested a vote for en banc consideration.

The petition for rehearing and the suggestion for rehearing en banc are accordingly denied.

FILED

SEP 19 1991

CATHY A. CATTERSON, CLERK
U.S. COURT OF APPEALS

* The Honorable M.D. Crocker, District Judge for the Eastern District of California, sitting by designation.

Supreme Court, U.S.
FILED
FEB 19 1992
OFFICE OF THE CLERK

No. 91-1177

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

LYNNE C. CZARNESKI,
Petitioner
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

Supplemental Brief and Appendix to Petition for Writ of Certiorari

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February 17, 1992

After Lynne C. Czarneski filed her Petition for Writ of Certiorari on January 17, 1992, the Ninth Circuit entered a new Order in the case on January 29, 1992, denying Lynne C. Czarneski's Motion to Remand the case back to the Tax Court. A copy of the new Order is included as a supplemental appendix to this supplemental brief. The context of the Ninth Circuit's issuance of the new Order crystallizes why certiorari should be granted in this case.

Lynne C. Czarneski first learned a Tax Court case had been tried against her and a Decision entered against her after her case was on appeal to the Ninth Circuit. Lynne Czarneski then hired separate counsel, who promptly filed a Motion to Remand the case to the Tax Court so that Ms. Czarneski could present an innocent spouse defense under I.R.C. §6013(e). The Ninth Circuit denied the Motion to Remand on January 8, 1991, without stating reasons. The appeal then proceeded to briefing and oral argument, and the Ninth Circuit's opinion of July 26, 1991, is included in the appendix to the original Petition for Writ of Certiorari.

In its opinion of July 26, 1991, the Ninth Circuit declined to address for the first time on appeal Ms. Czarneski's claim for a new trial. *See* appendix to Petition for Certiorari, p. A-7 and A-8, n. 5. The Ninth Circuit also suggested that Ms. Czarneski's remedy is to file a motion with the Tax Court under Tax Court Rule 161 (Motion to Reconsider Findings or Opinion) or Rule 162 (Motion to Vacate or Revise Decision) before attempting to bring the issue to the attention of the Ninth Circuit. *Id.* The Ninth Circuit acknowledged that the filing of the notice of appeal stripped the Tax Court of jurisdiction to decide a Rule 161 or 162 Motion with the Tax Court. *Id.* Nonetheless, the Ninth Circuit stated that Ms. Czarneski should file a Rule 161 or 162 Motion with the Tax Court seeking from the Tax Court an indication of whether the Tax Court would entertain either motion if it had jurisdiction to do so. The Ninth Circuit referred

to the procedure in the federal district courts under Rule 60(b) of the Federal Rules of Civil Procedure where a party seeks relief from "a final judgment, order, or proceeding" after a notice of appeal has been filed. *Id.*

Lynne C. Czarneski responded to the Ninth Circuit's July 26, 1991, opinion in two ways. First, she filed on August 9, 1991, a petition for rehearing and suggestion for rehearing *en banc* arguing, in part, that the Tax Court, as an Article I court, may not possess the equitable powers of a federal district court to give indications about post-trial motions over which the Tax Court admittedly has no jurisdiction to decide. Secondly, in good faith compliance with the Ninth Circuit's opinion, Ms. Czarneski on August 16, 1991 filed both Rule 161 and Rule 162 motions in the Tax Court relating the full situation and asking the Tax Court to give the Ninth Circuit the indications it requested.

The Ninth Circuit denied the petition for rehearing and suggestion for rehearing *en banc*. The Tax Court entered an Order on December 13, 1991, included on pages A46-A48 of the appendix to the original Petition for Writ of Certiorari. The Tax Court stated that because the Tax Court "does not have jurisdiction to exercise the broad common law concepts of judicial power invested in courts of general jurisdiction by Article III of the constitution, we are unable to decide an issue in the context of Fed. R. Civ. P. 60(b)." (citations omitted). A-48. The Tax Court, however, went on to do as the Ninth Circuit ordered and stated that "we are satisfied that an evidentiary hearing by this Court on petitioner's motions would be in order if the Court of Appeals sees fit to remand." *Id.*

Following the favorable Order of December 13, 1991, from the Tax Court, Lynne C. Czarneski then moved the Ninth Circuit for a remand to the Tax Court, all in accordance with the Ninth Circuit's opinion of July 26, 1991. Lynne C. Czarneski filed her Petition for Certiorari on January 17, 1992, while the Motion to

Remand was still pending in the Ninth Circuit. The Ninth Circuit then issued its new Order of January 29, 1992, denying remand for the second time.

The effect of the Ninth Circuit's rulings is to let stand a Decision against Lynne Czarneski that even the Tax Court, by virtue of its Order of December 13, 1991, recognizes is worthy of review by an evidentiary hearing on the issue of whether the Tax Court trial was conducted in violation of I.R.C. §§7452 and 7453, Tax Court Rule 201(a), ABA Rule 3.7, and Lynne Czarneski's due process rights, enabling her to present an innocent spouse defense under IRC §6013 (e). This Court should grant certiorari to clarify the law that an appellate court may consider Ms. Czarneski's due process claim for a new trial in this situation and to exercise this Court's supervisory power to preserve the integrity of both the Tax Court's and the Ninth Circuit's judicial process.

February 17, 1992

Respectfully submitted,

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NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

LYNNE C. CZARNESKI,
Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE SERVICE,
Appellee.

No. 90-70444
ORDER

Before: REINHARDT and FERNANDEZ, Circuit Judges.

The motion of appellant, Lynne Czarneski, to remand this case to the Tax Court is hereby DENIED without prejudice to her pursuing her rights, if any, before the Tax Court. It is noted that this court's mandate issued on November 4, 1991.

Filed Jan. 29, 1992
Cathy A. Catterson, Clerk
U.S. Court of Appeals

Supreme Court, U.S.
FILED
MAR 19 1992
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No. 91-1177

In the Supreme Court of the United States

OCTOBER TERM, 1991

LYNNE C. CZARNESKI, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether this case should be remanded for the Tax Court to consider a claim raised by petitioner for the first time on appeal.

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In the Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-1177

LYNNE C. CZARNESKI, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A9) is unreported. The opinion of the Tax Court (Pet. App. A9-A46) is reported as *Ewing* v. *Commissioner*, 91 T.C. 396.

JURISDICTION

The judgment of the court of appeals was entered on July 26, 1991. A timely petition for rehearing and petition for rehearing en banc was denied on September 19, 1991 (Pet. Supp. App). On December 4, 1991, Justice O'Connor extended the time for filing this petition to

and including January 17, 1992. The petition was filed on that day. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. During 1980 and 1981, petitioner's husband, Don A. Czarneski, purchased gold futures straddle contracts through an investment program that offered innovative methods for closing out the legs of straddle positions (Pet. App. A2-A3).[1] Petitioner and her husband deducted ordinary losses on their jointly filed 1980 income tax return from the cancellation of the losing legs of the tax straddles and reported long-term capital gains on their jointly filed 1981 return attributable to the gain legs (Pet. App. A12, A31-A32).

The Commissioner issued a statutory notice of deficiency to petitioner and her husband determining that they owed income tax deficiencies in the total amount of $202,075.41 and additions to tax totalling some $10,103.77 as a result of these transactions. Petitioner and her husband were divorced in 1983 (Pet. 4), but they elected to file a joint petition in the United States Tax Court contesting the deficiencies and additions to tax asserted by the Commissioner (Pet. App. A9-A11).

2. In the Tax Court, petitioner and her husband were represented by the law firm of Hochman, Salkin & DeRoy (HS&D). That firm had written a tax opinion concerning the straddle trading program and also had been instrumental in obtaining investors for the program (Pet. App. A29-A30, A40-A41). At the start of

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[1] In general, a futures contract is an agreement to either deliver or receive a specified quantity and grade of a designated commodity, such as gold, during a designated month in the future. If a person acquires a position for the purchase of a specified commodity in one month and a different position calling for the sale of the same commodity in a different month, his position is described as a "straddle" and each of the positions is referred to as a "leg" of the straddle (Pet. App. A13).

trial on November 18, 1985, the Tax Court therefore raised on its own motion the question whether HSD's participation as trial counsel created a conflict of interest (RT 18-19). Mr. Bruce Hochman of HS&D represented that he had "solicited all the Petitioners that could be impacted by this case * * * explaining the relationships, especially that of Mr. Salkin and the law firm, and they have all agreed that the law firm and myself can proceed to try the case" (RT 19). [2] At no time during the five-year period that her case was pending before the Tax Court did petitioner object to HS&D's representation of her interests.

On August 30, 1988, the Tax Court upheld the Commissioner's determination of deficiencies and additions to tax. *Ewing* v. *Commissioner*, 91 T.C. 396 (1988). In doing so, the Court found that any potential claims of conflict of interest had been waived (Pet. App. A10 n.2):

> [The Commissioner] stipulated that he has no objection to the law firm of Hochman, Salkin, & DeRoy and its individual members, including specifically Bruce I. Hochman and Avram Salkin, serving as counsel for the petitioners in these proceedings. At the suggestion of the Court, petitioners' counsel also sought and received specific waivers from the individual petitioners with respect to any potential conflict of interest.

3. Under Tax Court Rules 161 and 162, petitioner could have promptly moved the Tax Court to reconsider or revise its finding that petitioner had waived any potential conflict. Instead, petitioner docketed her appeal. Nine months after the Tax Court decision was issued, petitioner filed a motion in the court of appeals

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[2] In the Tax Court, this case was consolidated for trial, briefing, and opinion, with several other cases involving taxpayers who had participated in the same futures trading program (Pet. App. A9 n.1).

requesting that the case be remanded to the Tax Court so that she could contest the finding that she had waived the potential conflict. That motion was denied by the court of appeals on January 8, 1991.

On July 11, 1991, the court of appeals affirmed the Tax Court decision. In doing so, the court declined to consider the conflict of interest claim raised by petitioner for the first time on appeal. The court noted, however, that "Ms. Czarneski's proper remedy *would have been* to file a motion in the tax court under Tax Court Rules * * * 161 or 162" (Pet. App. A7 (emphasis added)). The court declined to remand the case for further proceedings, but noted that its affirmance "was not intended to preclude [petitioner's] rights, *if any*, to raise her claims of conflict before the tax court" (*id.* at A8 (emphasis added)).

4. After the Tax Court decision was affirmed on appeal, petitioner moved the Tax Court to reconsider its finding that she had waived any potential conflict of interest. On December 13, 1991, the Tax Court entered its order denying that motion, concluding that it lacked jurisdiction to consider the matter because the case had not been remanded to it by the court of appeals and because, unlike the federal district courts, the Tax Court lacks jurisdiction to grant post-trial relief under the procedures of Rule 60(b) of the Federal Rules of Civil Procedure (Pet. App. A46-A48).[3]

On January 9, 1992, petitioner filed a motion with the court of appeals again requesting a remand to the Tax Court for a hearing on the conflict of interest claim. On January 29, 1992, the court of appeals denied petitioner's motion, noting that its mandate had issued on November 4, 1991 (Pet. Supp. Br. 4).

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[3] The Tax Court is a court of limited jurisdiction. See *Commissioner* v. *McCoy*, 484 U.S. 3, 6 (1987); *Handeland* v. *Commissioner*, 519 F.2d 327, 329 (9th Cir. 1975).

ARGUMENT

The court of appeals correctly declined to remand this case to the Tax Court for consideration of an issue raised by petitioner for the first time on appeal. The decision in this case does not conflict with any decision of this Court or of any other court of appeals. Further review is therefore not warranted.

1. a. "It is the general rule, of course, that a federal appellate court does not consider an issue not passed upon below." *Singleton* v. *Wulff*, 428 U.S. 106, 120 (1976). See *Youakim* v. *Miller*, 425 U.S. 231, 234 (1976); *California* v. *Taylor*, 353 U.S. 553, 557 n.2 (1957); *Hormel* v. *Helvering*, 312 U.S. 552, 556 (1941).[4] The court of appeals thus correctly held in this case (Pet. App. A7 n.5) that petitioner's claim of a conflict of interest is foreclosed by her failure to raise that claim in the Tax Court. The Tax Court proceedings began in May 1984. The Tax Court entered its decision adverse to petitioner in March 1990. Yet petitioner did not seek to raise the issue of a conflict of interest until December 1990, after her case was already pending on appeal.

Even if petitioner did not discover the grounds for her claim until after her appeal was filed, "that still does not allow her to raise the issue for the first time on appeal" (Pet. App. A7 n.5). Since extreme prejudice to

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[4] In *Hormel* v. *Helvering*, 312 U.S. at 558-559, this Court held that a court of appeals may properly consider legal (not factual) arguments not presented to the trial court when "there have been judicial interpretations of existing law after decision below and pending appeal—interpretations which if applied might have materially altered the result." *Ibid.* Contrary to petitioner's contention (Pet. 6), the decision in *Hormel* does not conflict with the decision in the present case. The present case does not involve new legal interpretations of existing law that were issued between trial and appeal. Instead, petitioner seeks only to challenge for the first time on appeal the factual determination made by the Tax Court that she waived any potential conflict at the trial.

litigants—and an enormous waste of both private and judicial resources—would result from allowing parties to raise new issues on appeal, this Court has long held that it is "essential" (*Hormel* v. *Helvering*, 312 U.S. at 556) that parties raise their claims first at trial.[5]

b. Petitioner errs in suggesting (Pet. 9) that, if the case is not remanded for further consideration by the Tax Court, there is no other remedy for the alleged conflict of interest that she seeks to assert for the first time on appeal. If, notwithstanding the contrary assertions of her trial counsel and the findings of the Tax Court, petitioner could establish that she was not aware of and did not waive the alleged conflict of interest, her remedy would be an action for malpractice against her counsel for any damages proximately caused by his actions. See *Link* v. *Wabash R.R.*, 370 U.S. 626, 634 n.10 (1962).

Petitioner does not have a constitutional right to effective assistance of counsel in a civil suit, as she appears erroneously to contend (Pet. i, 8-10). Civil litigants are not entitled to a new trial simply because they believe that certain arguments should have been made on their behalf or that trial counsel had an impermissible conflict of interest and should have ceased his representation. Their remedy in these circumstances is not a new trial, but is a suit for malpractice against their counsel. See *Link* v. *Wabash R.R.*, 370

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[5] *Guenther* v. *Commissioner*, 889 F.2d 882 (9th Cir. 1989), on which petitioner seeks to rely (Pet. 9), is inapposite. In *Guenther*, the taxpayer had requested the Tax Court to disclose information contained in an ex parte memorandum that had been submitted to that court by the Commissioner. 889 F.2d at 883. The Tax Court refused the taxpayer's request. On appeal, the court of appeals remanded the case for the Tax Court to make findings concerning the ex parte submission. *Id.* at 885. The challenge to the ex parte communication in *Guenther* had been raised initially in the Tax Court and was not, as in the present case, raised for the first time on appeal.

U.S. at 633-634 & n.10; *Nicholson* v. *Rushen*, 767 F.2d 1426, 1427 (9th Cir. 1985) ("a plaintiff in a civil case has no right to effective assistance of counsel"); *Wolfolk* v. *Rivera*, 729 F.2d 1114, 1119-1120 (7th Cir. 1984) (same); *Slavin* v. *Commissioner*, 932 F.2d 598, 601 (7th Cir. 1991); *Mekdeci* v. *Merrell Nat'l Laboratories*, 711 F.2d 1510, 1523 (11th Cir. 1983); *Watson* v. *Moss*, 619 F.2d 775, 776 (8th Cir. 1980); *Kushner* v. *Winterthur Swiss Insurance Co.*, 620 F.2d 404, 408 (3d Cir. 1980); *United States* v. *Rogers*, 534 F. 2d 1134, 1135 (5th Cir.), cert. denied, 429 U.S. 940 (1976).[6]

2. The Tax Court's finding that any potential conflict was waived by petitioner is amply supported by the record. The Tax Court specifically raised the question whether a conflict of interest existed on the first morning of trial (RT 18-19). Mr. Bruce Hochman of the law firm of Hochman, Salkin & DeRoy (HS&D), stated that counsel for the Commissioner previously had raised the question whether HS&D should try this particular case. Mr. Hochman represented at trial that, after the Commissioner's inquiry, he had "solicited all the Petitioners that could be impacted by this case * * * explaining the relationships, *especially that of Mr. Salkin and the law firm*, and they have *all* agreed that the law

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[6] The rule set forth in these cases reflects the dichotomy between civil and criminal proceedings. The harm effected by ineffective assistance of counsel in criminal cases—a potentially erroneous deprivation of liberty—cannot be fully redressed by a malpractice suit against the attorney. The appropriate remedy for ineffective assistance of counsel in a criminal case is therefore reversal of the conviction. See *Holloway* v. *Arkansas*, 435 U.S. 475 (1978). In civil cases, however, the harm effected by counsel's ineffective assistance—an allegedly erroneous monetary judgment—can be fully redressed by a malpractice suit against the attorney. It is therefore well settled that parties in civil proceedings can not avoid the consequences of the acts or omissions of their attorneys but must seek redress through an action for malpractice. *Link* v. *Wabash R.R.*, 370 U.S. at 633-634 & n.10.

firm and myself can proceed to try the case" (RT 19 (emphasis added)).[7] Counsel for the Commissioner also stated at trial that the government had no objection to proceeding with the case "in light of the fact that the Petitioners' counsel solicited waivers from all the Petitioners with respect to the conflict of interest situation" (RT 19). On this record, the Tax Court did not err in finding that the alleged conflict of interest had been waived by all taxpayers, including petitioner.[8]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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Attorneys

MARCH 1992

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[7] It is not disputed that petitioner was aware that the HS&D lawfirm was representing her in the Tax Court. During 1984, petitioner signed a power of attorney form authorizing HS&D to represent her in connection with these tax issues. Motion For Remand, Affidavit of Lynne Czarneski and attached exhibits.

[8] *Duffey* v. *Commissioner*, 91 T.C. 81 (1988), on which petitioner relies (Pet. 8), is distinguishable. In *Duffey*, the Tax Court granted the Commissioner's motion to disqualify the taxpayers' counsel from representing them at trial. In this case, by contrast, all parties stipulated at trial that the potential conflict would be waived (Pet. App. A10 n.2).

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No. 91-1177

IN THE

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OCTOBER TERM, 1991

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v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioner's Reply to Brief in Opposition

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March 25, 1992

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No. 91-1177

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OCTOBER TERM, 1991

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COMMISSIONER OF INTERNAL REVENUE,
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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioner's Reply to Brief in Opposition

The "Brief for the Respondent in Opposition" filed by the government in this matter ignores entirely the illegality of petitioner's trial counsel being allowed to testify as a material witness without petitioner's knowledge. The government's response also makes misstatements to this Court about the facts of this case.

The government's response totally fails to address the matter of the Tax Court improperly allowing petitioner's trial counsel to testify as a material witness, a matter that petitioner was totally unaware of until she discovered such fact after petitioner's trial counsel had lodged her appeal on other issues. By allowing her

trial counsel to testify as a material witness, the Tax Court permitted violations of Rule 3.7 of the Rules of Professional Conduct of the American Bar Association, which is incorporated into Rule 201(a) of the Tax Court Rules of Practice and Procedure, which in turn is required to be complied with by I.R.C. §§ 7452 and 7453. The Tax Court's permitted violation of the law in such manner was inconsistent with its decision in *Duffey v. C.I.R.*, 91 T.C. 81 (1988). The Ninth Circuit's refusal to consider the violation of law permitted by the Tax Court because it was not first raised by petitioner's trial counsel is a gross legal error as discussed in the petition filed in this matter. I.R.C. § 7482(c)(1); *Hormel v. Helvering, C.I.R.*, 312 U.S. 552, at 558 (1941).

The government's response incorrectly attempts to couch petitioner's complaint as only having to do with the absence of any waiver of a conflict of interest by petitioner. The illegality of what the Tax Court permitted went beyond a mere conflict of interest issue. Permitting trial counsel to testify as a material witness was a denial of due process to petitioner and erroneous as a matter of law. It is not something that is even susceptible to being waived or consented to as are some conflicts of interest. *Duffey v. C.I.R.*, 91 T.C. 81 (1988). The Ninth Circuit had the authority under I.R.C. § 7482(c)(1) and this Court's decision in *Hormel v. Helvering, C.I.R.* to correct the Tax Court's permitted violations of the law by rendering a decision holding that the conduct of the trial was illegal and remanding the matter to the Tax Court to be tried in accordance with the law.

These same authorities cited by petitioner would also permit the Ninth Circuit to remand the matter of the absence of a waiver of conflict of interest by petitioner to the Tax Court. The government's attempt to relegate the Tax Court and the Ninth Circuit's error to concern only a conflict of interest, however, is merely an attempt to make the error appear less egregious than it

is. Furthermore, the government's discussion of whether one has a constitutional right to effective assistance of counsel in a civil case is merely diversionary and is not applicable to the issues in this case.

The government and the Ninth Circuit have also failed to address the fact that petitioner could not have raised at trial the impropriety of her trial counsel's dual role as material witnesses. This was because she was unaware of the trial to begin with and unaware of her trial counsel's dual role and the Tax Court's erroneous allowance of such dual role until after the very same trial counsel had lodged an appeal on other grounds. The government knows that petitioner was divorced from her husband approximately one year before the petition was filed, that she was unaware of not only the trial taking place but also the docketing of her appeal by her trial counsel and she never signed any waiver of a conflict of interest. Her trial counsel did such things without her knowledge and misrepresented to the Tax Court that she had signed a waiver of any conflict of interest. Her trial counsel even admitted in their opening brief to the Ninth Circuit that "[a]ll actions taken with respect to the transactions that are the subject of this appeal were taken by the male appellants only." (Opening Brief for Appellant, Ninth Circuit, p. 1.) The government's ignoring of these facts is an attempt to deny petitioner a fair opportunity to litigate her innocent spouse defense under I.R.C. § 6013(e). Unfortunately this is a recurring inequity for divorced women whose ex-husbands and their representatives ignore their rights and continue to handle the joint tax return litigation as they originally handled the filing of the joint tax return, i.e., without any knowledge of the wife. This is the very reason Congress passed the innocent spouse provision of I.R.C. § 6013(e)[1].

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[1] At Footnote 7, page 8, of the "Brief for the Respondent in Opposition" the government misrepresents that petitioner signed a power of attorney authorizing Hochman, Salkin & DeRoy to represent her. The power of attorney only appointed Hochman, Salkin & DeRoy to

To allow the decisions against petitioner to stand would be a great miscarriage of justice. Additionally, this Court should correct the Ninth Circuit's position in this case that it did not have the authority to correct the violations of law and denial of due process that took place in the Tax Court.

March 25, 1992

Respectfully submitted,
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represent petitioner's ex-husband, Don A. Czarneski, before the Internal Revenue Service and had nothing to do with representing anyone in U.S. Tax Court. In fact, Treasury Regulation § 601.509 (as amended in 1980) specifically provides that a power of attorney is not to be used by a party litigant before the U.S. Tax Court.